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# FOREIGN COMMERCIAL CREDITS

## A STUDY IN THE FINANCING OF FOREIGN TRADE

BY

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TO MY MOTHER



## INTRODUCTION

A review of the banking and business history of the past eight years, with special reference to the foreign trade conditions produced by the war, throws into high relief a series of defects and omissions which have been only too characteristic of the practice of American banks and business men. There are many large questions of policy, still unsettled, whose adjustment will be essential before the future of our international trade relations can be in any degree predicted. The tariff, our foreign branch bank policy, our methods of extending credit in foreign trade, the conditions under which foreign bonds may be marketed in the United States, and a variety of others to which we formerly gave but scant attention, are now matters of earnest study in many quarters.

There are other issues, more technical in nature but in their way quite as significant as the broader questions to which attention has just been directed, whose settlement is imperative. Among these is the problem of commercial credit practice in its various aspects. The war and the post-war reaction brought home to American business men the fact that our technique of foreign financing, and indeed of foreign trade generally, is far inferior to the manufacturing equipment, and of course to the agricultural development, upon which the volume of our possible exports depends. The return of sharp competition with foreign producers which has been a noteworthy feature of post-war trade has emphasized the fact that, even with their systems disorganized by the disturbances of 1914-18, foreign nations are, in numerous respects, better equipped in matters which call for close competition than are we. Many points of technique both in production and finance require far more careful treatment than they have ever had in the past from our banks and business houses. The practice, so prevalent in former years of selling our goods to foreign buyers only for cash or its equivalent, placed us at a competitive disadvantage, and, so far as use on any large scale was concerned, early broke down. Still less satis-

factory was the lax practice which grew up, during the latter days of the war and the period immediately after it, of selling on open account to foreign buyers whose credit had not been well ascertained. Manufacturers who thus disposed of goods, or who discounted at their banks bills drawn on foreign buyers for which they themselves retained an indefinite contingent liability, have in many cases suffered seriously in consequence.

The lessons of the war and of the active period of international trade which grew out of it are not appropriate solely to the United States. Thus far but little has been accomplished in the direction of uniformity of practice among different nations. The efforts which had been made in this direction before the opening of the war had naturally to be suspended; and other matters have subsequently been too pressing to permit any resumption of the discussions which had previously been in progress. But such effort to bring about uniformity of commercial practice between different nations could hardly be successful in any case, without practical agreement among the traders of each of the participating countries with regard to uniformity of practice on their own part. A first and fundamental step, therefore, toward the laying of a sound foundation for foreign trade must be the definite ascertainment of existing practices in the financing of foreign shipments, the comparison of these practices, and the elimination of those which are found to be without sound basis.

It was with these ideas in mind that the Division of Analysis & Research of the Federal Reserve Board some years ago undertook the analysis, through information compiled from first-hand sources, of existing methods employed by American banks and traders in connection with foreign commercial credits. The study was afterwards broadened to include comparative analyses of the commercial credit practices of other countries; and, as finally carried out, involved an extensive study of banking methods abroad. This work was placed in charge of Dr. George W. Edwards, Assistant Professor of Banking in Columbia University, who undertook the assembling of the data required. In the course of his work, he became associated with the Bankers' Credit Conference (an organization composed of representatives of some of the chief banks of New York City), which had already addressed itself to certain kindred problems.

With the aid and coöperation of leading banks, exporters, manufacturers and business men, Dr. Edwards, representing the Division of Analysis & Research, eventually gathered matter for a series of studies of which the chief were published from month to month in the Federal Reserve Bulletin and which have furnished the basis for numerous current writings on the subject. Some portions of the work, however, had reference to matters either already partially dealt with elsewhere, or in some cases not precisely available for publication in an official journal dealing only with the results of fact-studies, in the narrowest sense of the term, and seeking to confine itself entirely to the results of original investigation. In the present volume, Dr. Edwards furnishes explanatory data and discussions which throw light upon the information already officially assembled and published and which place this information in its true relations to existing business conditions. It is a work which should be of high value to bankers and foreign traders who desire either a clear-cut exposition of actual practice or who are seeking to clarify or improve their own methods.

Dr. Edwards' work does not permit of abbreviated description since it is itself a closely packed summary of facts and conclusions. One or two matters, however, stand out clearly as deserving the reader's special attention. One of these is the necessity of agreement between business men, and probably of Federal legislation, designed to clarify and unify commercial credit practice. Another is the difficulty of financing foreign trade and of ascertaining the rating of foreign buyers by the use of existing banking and credit machinery. Dr. Edwards' analysis shows in convincing fashion the points at which our present methods are defective, and suggests even where it does not specifically indicate, the lines of work which must be pursued in order to bring about a better condition of affairs. Light is also thrown upon the impossibility of developing a satisfactory foreign trade technique through mere exhortation. The evils which have arisen in American bank acceptance practice and the failure to obtain for this type of instrument the world status which it must have if it is to compete with the sterling bill, afford convincing evidence of the harm which may come from indiscriminate advocacy and hasty adoption of types of financing whose principles and limitations are not well understood by those

who are to use them. Our acceptance practice must be clarified and improved through better understanding of the banking methods which underly foreign trade before we can expect to attain much success in the use of such paper.

This and many other matters of inference will suggest themselves to the reader of Dr. Edwards' study. It is essentially a scientific inquiry, not intended, as have been too many other publications upon kindred topics, for propaganda purposes, but designed only to inform the business reader and to make available to him the latest results of investigation upon a subject which touches him nearly. Studies of business and banking practice, conceived from a practical standpoint and intended for the use of men of affairs have been increasingly numerous in recent years. Dr. Edwards' volume is a valuable addition to this growing body of scientific business literature.

H. PARKER WILLIS,  
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*Columbia University.*

## PREFACE

The letter of credit has been the fundamental method of financing foreign trade for many years. In the half century before 1914, its operation was carefully developed by bankers and merchants. The war and its aftermath of fluctuating exchanges and commodity prices seriously disturbed foreign trade, and the letter of credit became the subject of bitter controversy among the various parties engaged in international commerce. These difficulties were often referred to the courts, but many questions still remain unsettled. The entire subject of foreign commercial credits is at present in a rather uncertain state and comparatively little literature has been written on it.

The object of this book is to set forth the practical and legal principles underlying the letter of credit. It should therefore be of interest to bankers, business men and attorneys who are engaged in applying these principles to specific problems. This work should also prove of use in courses on foreign banking and foreign trade, as it deals with a subject which is of general importance but which has not yet been presented in book form.

The various aspects of commercial letters of credit are presented with special reference to the tendency toward the standardization of documents and practice in foreign trade. Consideration is given first to the various commercial documents which determine the relations of all the parties to a transaction in international commerce. These relationships have been seriously deranged since 1914 and attention will therefore be given to the new conditions which have arisen out of the war. The innumerable controversies among bankers and merchants have been due in a large degree to misunderstandings as to the meaning, and classification of commercial credits, and their relation to general banking theory. A chapter is devoted to the traveler's letter of credit which is often confused with the commercial letter. The legal theory of the letter of credit, and the cases which have arisen in American courts are analyzed. Attention

is also directed to the authority to purchase, which performs the same function as the letter of credit, but differs widely in nature and operation. Finally, British, German, Japanese and Continental methods are studied for the purpose of comparing them with American practices. The appendix includes material illustrating the text.

The author has in part drawn material from a series of special articles written by him for the Federal Reserve Bulletin during 1921 and 1922, but the following text contains considerable material which could not well be included in an official publication.

These studies were suggested by Dr. H. Parker Willis, Director of the Division of Analysis and Research of the Federal Reserve Board, and were prepared under his direct guidance. Dr. W. H. Steiner, Assistant Director of the Division, read the manuscript and gave many valuable suggestions. An acknowledgment of indebtedness is also due to M. Nadler of the Division, who has been associated with the author in the various studies on commercial credits.

GEORGE W. EDWARDS.

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# FOREIGN COMMERCIAL CREDITS

## CHAPTER I

### THE MOVEMENT TOWARD UNIFORMITY IN COMMERCIAL DOCUMENTS

The industry of the United States has developed so rapidly in recent years that domestic demand is insufficient to absorb the enormous production of American-made goods. In consequence, foreign markets in the past have been and in the future must be sought. The depression which in 1920 and 1921 weighed so heavily upon American business was in a large measure caused by a decline in our export and import trade. And no permanent revival of industry is possible without a restoration of the movement of goods to foreign markets. Indeed, with the international situation which the war has brought about, the development of foreign trade among American business men must inevitably be more extensive in the future than ever before. For this reason, the importance of a clear understanding by American merchants of methods of financing foreign trade was never greater than today.

This study does not present a survey of the broader principles of foreign trade or even of its financing. It is rather confined to an analysis of the instruments which express the relations among the various parties to transactions in international commerce. In its early history, foreign trade involved only one party, the "merchant-adventurer" who bought a variety of goods abroad, carried them in his own vessel and then sold them. Transactions in foreign trade today include not alone merchants of different countries, but also bankers, underwriters, and shipowners. The relations among these parties and their rights and liabilities are defined in such documents as the commercial invoice, bill of exchange, policy of marine insurance

and bill of lading. Although these documents are carefully worded, they cannot cover all the difficulties which arise from the special nature of foreign trade, for commerce among countries is governed by different sets of laws, different standards of business ethics, and different forms of currency. Also foreign trade develops keen competition among the merchants of the various countries, as, for example, the rivalry among British, German and American business firms for the markets of South America.

In recent years the various parties interested in foreign trade have attempted to settle some of their difficulties through informal agreements among themselves or through legislative enactments by their respective governments. These rulings and laws express the principles generally recognized by commercial usage, and represent a movement to attain greater uniformity amid the ever-increasing perplexities of modern international business.

**I. Uniform Negotiable Instruments Act.**—British commercial law on bills and notes was gradually developed during the eighteenth century and finally codified in the English "Bills of Exchange Act" of 1882. This legislation later formed the basis for the American Uniform Negotiable Instruments Act which since 1896 has been adopted by most of the states of the Union. This Anglo-American system of law on bills and notes was in time copied by many other nations. In 1910 a conference was held at the Hague for the purpose of establishing an international code on bills of exchange, and later it submitted a set of regulations which became known as "Provisions adopted by the Convention of the Hague of 1912." They were adopted by many countries of Europe and South America, and at the present time there are two general legal systems of negotiable instruments throughout the world, the Anglo-American law and the Convention of the Hague.

**II. York-Antwerp Rules.**—The tendency toward uniformity has also been developed in the field of marine insurance, which for centuries presented many complicated problems. In an effort to solve some of them, a body of jurists, shipowners, insurance underwriters, and business men known as the Association for the Reform and Codification of the Law of Nations met at York, England, in 1864, and later at Antwerp, Belgium, in 1877,

and agreed upon a body of rules. In 1890 they were revised and have since been known as the "York-Antwerp Rules."

**III. Hague Rules of 1921.**—In addition to the bill of exchange and the policy of marine insurance another fundamental document in foreign trade is the bill of lading. Originally it was simply a receipt in which the shipowner acknowledged the delivery of certain goods by the shipper. With the development of foreign trade, the risks in loading and discharging cargoes from elevator, pier and lighter to vessel have multiplied considerably. On the other hand, keen competition among modern maritime countries for the world's carrying trade reduced freight charges. In order to carry freight at the cheapest possible rates, transportation companies were able to allow only a small overhead cost to cover losses arising from the many risks in handling freight. To curtail such costs, shipowners adopted a policy of inserting in their bills of lading clauses which exempted them from many liabilities. As these protective clauses were enlarged, the burden of carrying shipping risks was to a considerable degree shifted from shipowners to cargo owners. The latter naturally objected to this tendency and the United States induced Congress finally in 1893 to pass the Harter Act.

This statute forbids a shipowner from inserting in his bill of lading any clause freeing him of liabilities arising from the ordinary carrier's risks in loading and discharging cargoes. The shipowner is, however, relieved of navigation risks, providing his vessel is seaworthy. The general provisions of the Harter Act must be embodied in the bills of lading issued by every shipowner, whether American or foreign, who is carrying goods from ports of the United States. Similar acts have been passed by Canada, New Zealand, Australia and Japan. In these countries where legislation prohibits the insertion of exemption clauses, the shipowner's freedom of contract is said to be limited. In Great Britain and in most Continental countries, these restrictive laws have not been passed, and so the shipowner's freedom of contract is described as absolute. In fact under British law, a shipowner is able to word his bill of lading in such a way as to contract out any part or even all of his liability for the cargo which he is carrying. These conditions imposed disabilities upon firms engaged in foreign trade, and British mercantile associa-

tions for a number of years sought some form of relief. In 1920 Mr. Lloyd George appointed the "Imperial Shipping Committee" which among other matters recommended "uniform legislation throughout Europe on the lines of the existing acts dealing with shipowners' liability." As the effect of such legislation would not alone be national but international in its scope, the entire matter was referred to the Maritime Law Committee of the International Law Association. This body in turn called an International Conference at the Hague. The meeting was attended by representatives of the shipowning, mercantile, banking and underwriting interests of many countries.

The conference first discussed the question of whether uniformity in bills of lading should be attained by legislative action. This proposal was rejected because the members of the conference disapproved of any extension of State control over shipping. Instead the conference adopted a set of regulations known as the "Hague Rules of 1921." (See Appendix II, pp. 216-222.) While differing in details, the Hague rules embody the general principles of the Harter Act, and so American shipowners are asked to recognize the new regulations by merely inserting in their bills of lading the expression, "Hague Rules, 1921, will apply." The Hague Rules have been endorsed by many commercial and banking organizations both in England, Continental Europe and the United States, and it is planned to have these regulations serve as an international code.<sup>1</sup>

**IV. Foreign Trade Definitions.**—The relation between buyer and seller is generally expressed in a contract of sale of which an important part is the price quotation or term of sale. In foreign trade these quotations have generally been expressed to save cable charges in abbreviated symbols, such as c.i.f. (cost,

<sup>1</sup> For further discussion of the Hague Rules see S. D. Cole "*The Hague Rules 1921 Explained*"; *Nation's Business*, November, 1921; *Journal of Commerce*, Oct. 6, 1921, Nov. 22, 1921, Feb. 13, 1922; *Report of Proceedings of Association of British Chamber of Commerce*, 1921; *Report of International Chamber of Commerce, Committee on Transportation and Communications*; *Manchester Chamber of Commerce Monthly Record*, December, 1921; *Bank of Liverpool and Martins, Limited, Monthly Circular*, October, 1921; *Lloyds Bank Monthly Financial Report*; *The Economist* (London) Nov. 19, 1921, p. 866; *Commerce Reports*, Feb. 20, 1922, pp. 472-4, Feb. 27, 1922, pp. 527-9. *Memoranda on Hague Rules* prepared by Institute of Packers.

insurance, freight), which have lacked uniformity and so have caused considerable confusion. In order to standardize these terms, a committee representing nine of the more important commercial organizations of the United States at a meeting in New York in 1919 agreed to adopt a set of standardized definitions. (See Appendix II, p. 215.) In commenting upon them, the Conference remarked that "not all have as yet the force of law or long established practice, but it is the hope and expectation of the Conference that these recommendations will receive such adherence on the part of American producers and distributors as to make them in fact the standard American practice. And it is therefore expected that in due time they will receive the sanction of legal authority." Since 1919 these expectations have been fully attained, for the definitions have been widely accepted by merchants and bankers.

**V. Forms and Regulations of the Commercial Credit Conference.**—American mercantile interests also initiated the movement to standardize the commercial letter of credit. As will be later shown, it is a fundamental commercial instrument, for it involves practically all the parties to a transaction in foreign trade. Representatives of large export concerns were the first to point out the conspicuous lack of uniformity in the letters of credit issued by American banks, and to urge the need of standardized forms. J. P. Beal, of the American Steel Export Company, writing in the *Bankers' Magazine* for August, 1917, p. 275, commented as follows:

"It is interesting to note the many different forms used by the various banks; they all seem to be different in some respects. Some banks merely write an explanatory letter on their regular letter heads, while others have forms set up on which to record the various points in relation to the terms of the credit. When one considers the vast number of these daily transactions by all the banks having foreign departments or foreign correspondents of any importance, it would only seem natural that some concerted action be taken by the banks to standardize, as much as possible, the forms for reporting letters of credit."

Omer F. Hershey, General Counsel for the American Steel Export Co., presented the legal aspects of the letter of credit in a scholarly article in the *Harvard Law Review* (November, 1918, pp. 1-39). The letter of credit, he states,

"has come into common use in our foreign trade only since the war, on this account, in spite of the enormous volume of business in which these letters now figure, they show a great lack of uniformity in form and content, and some lack of certainty in their practical construction and their legal scope and meaning. Commercial letters of credit, while in use for a long time in our business world, have attained no standardization of either kind, form or legal construction."

This article was reprinted by the American Steel Export Co., whose President added the following comments:

"To ask the courts to do what seems to me to be so obviously proper presupposes that business men and banks have done their part to simplify and standardize these documents and to make sure that they themselves always know what is intended by them. Our experience is that at present hardly two institutions issue the same form of letter."

In an address before the National Foreign Trade Convention of 1920, Mark M. Michael, Treasurer of the Consolidated Steel Corp., set forth the need of a standardized letter of credit, and presented a proposed form with explanatory regulations.

In the same year the matter was taken under consideration by the Bankers' Commercial Credit Conference. This body had been organized early in 1920 to bring about coöperation among New York and Boston banks in solving export credit problems, especially those concerned with bills of lading. A certain degree of uniformity in practice was attained through the adoption of a set of "Regulations Affecting Export Commercial Credits." In November, 1920, the Conference appointed a committee to draft a set of standardized forms. Coöperating with this committee, the Division of Analysis and Research of the Federal Reserve Board made a survey of the forms and practices of American banks, and as there were differences of opinion among bankers and merchants, the Division also sought the views of the latter on some of the controversial phases of commercial credits. The results of these studies were printed from time to time in the *Federal Reserve Bulletin*.

## CHAPTER II

### PRESENT STATUS OF SHIPPING DOCUMENTS

Loans may be classified as unsecured or secured. In granting an unsecured loan, the lender is relying solely on the credit standing of the borrower, or rather on his future ability to make repayment. If the future solvency of the borrower is questioned by the lender, he asks for some form of property, or right to property, which serves as collateral for the loan. In the United States the greater part of domestic loans are unsecured, since American mercantile houses and banks have developed an efficient system of gathering and analyzing credit information. It is difficult to obtain such data concerning firms in other countries due to the difference in nationalities and the general disinclination to furnish confidential information to foreigners. Because of this inability to obtain credit data regarding business houses abroad, most loans extended in overseas trade are based on some form of collateral. This security in the case of a foreign investment transaction may consist of stocks or bonds, and in the case of a commercial transaction may be composed of commercial documents representing merchandise in transit from one country to another. As stated in the previous chapter, these documents usually include the bill of exchange, bill of lading, policy of marine insurance and commercial invoice. In addition to these primary documents, there are several certificates of minor importance used only in special cases. The nature of all these documents has been well presented in a number of treatises dealing with foreign trade, and so only the general characteristics will here be viewed briefly, while detailed consideration will be given to those special features which have developed during and since the War.

**I. Bill of Exchange.**—Bills of exchange are classified primarily according to whether the parties are bankers or merchants. A banker's bill is an order drawn by one bank on another to pay a specified sum of money. The drawee bank is usually a correspondent carrying a balance previously deposited by the

drawer. The usance of the bill may be either sight or time. As a banker's sight bill is drawn on a bank and is also payable on demand, it possesses the features of an ordinary check and is frequently known by that name. It is in every respect a negotiable instrument, and is usually payable to the order of a party. This sight draft, or check, is used when a bank sells foreign exchange. A person in New York, wishing to send £100 sterling to London, purchases this amount of foreign exchange from his bank, and generally receives a draft drawn against its balance with a British correspondent. The purchaser then forwards the draft by mail to the payee, who receives the money on presenting the instrument to the drawee bank in London. In large transactions where quick communication is necessary, or in time of war when international mail service is uncertain, the cable transfer is used. As it is an order given by a bank to its correspondent to pay an amount of money on demand, the cable transfer is simply a form of banker's check. The two forms of exchange differ in that the cable transfer is forwarded over cable or wireless by the selling bank directly to the payee, while the check is given by the bank to the purchaser, who himself undertakes the responsibility of transmitting it. Furthermore, the cable transfer is payable only to a specified party and is thus non-negotiable, while the check is usually drawn to order and is thus transferable.

Bankers' bills drawn on a time basis state that payment will be made on a certain date or a number of days after sight. These time bills are further grouped according to whether the maturity is over 30 days. If less, they are called short bills; if over, they are termed long bills. Drafts of the latter type usually have a maturity of 60 or 90 days, and seldom more than 120.

Bankers' bills also may be classified according to the purpose for which they are drawn. A bank in the course of its business creates foreign-exchange bills to cover the shipping of goods, reimbursing of freight charges, meeting of insurance premiums, forwarding of remittances, and paying of tourists' expenses. Of a different nature are those bills drawn in order to move funds to a foreign money market. These advances are described as loan bills when supported by collateral and are termed finance bills when based only on pure credit.

Trade bills are instruments to which the parties are merchants. These bills are classified, in general, according to time and purpose. Demand bills can be drawn only by firms with extensive foreign business, but greater use is made of time drafts. These, in turn, are either long or short, depending upon whether their maturity is more or less than 30 days. As to purpose, bills drawn by commercial houses follow a classification quite different from that of bankers' bills. Drafts which arise from the reimbursement of services cannot well be accompanied by any documents representing property which could serve as collateral. Such bills are described as clean or unsecured, and so their value depends primarily upon the credit standing of the acceptor and secondarily upon the drawer. This group also includes all bills from which documents have been detached. Of greater importance in foreign exchange are drafts accompanied by certificates or documents evidencing the ownership of some form of property, and which therefore are called documentary or secured bills. They may be protected, as mentioned above, by stocks and bonds which have been ordered by foreign investors or by shipping documents covering goods imported by merchants.

**II. Bill of Lading.**—The first of the shipping documents to be considered is the bill of lading. It is primarily a receipt in which a transportation company acknowledges that it has accepted from a shipper certain merchandise to be carried from one specified place to another. The instrument contains a detailed statement of the terms according to which the goods shall be moved. But a bill of lading is more than merely a receipt, for it is also a document of title evidencing the ownership of the goods. This certificate may therefore serve as a form of credit instrument since it is a lien upon the merchandise and can be freely transferred by the rightful holder to another party, such as a banker who has granted a loan on the strength of this security.<sup>1</sup>

In performing the functions of a receipt and a document of title the bill of lading involves several parties. The party who presents the goods for delivery is variously known as shipper, cargo owner or consignor. The acceptor of the goods for trans-

<sup>1</sup> For legal aspects of bills of lading, see Bennett, *Bill of Lading*, Poor, *Charter Parties*, and Ocean Bills of Lading, Scrutton on *Charter Parties and Bills of Lading*.

portation is called the carrier, and the receiver to whom delivery is ultimately made is termed the consignee. In addition to these three parties, mention must also be made of the banker who grants a loan on the merchandise as represented in the bill of lading, and thereby becomes an interested party.

It was formerly a simple matter to present a classification of bills of lading, but the usual grouping of these instruments has been deranged by the unsettled conditions in commerce since 1914. During recent years innumerable controversies have arisen among consignors, consignees, carriers and bankers. The efforts of these parties to settle their differences have been outlined in the previous chapter, and in attempting a current classification of bills of lading, due consideration must be given to such influences as regulations adopted by mercantile and banking organizations, acts passed by legislative bodies and decisions rendered by courts. Bills of lading will be classified according to such factors as freight, negotiation, number, issue, route, qualification, and shipment.

- ✓ 1. *Freight*.—Bills of lading may be grouped according to nature of the freight. This may be either general merchandise such as automobiles, farm machinery and hardware, or staple commodities such as sugar, cotton and grain. A banker is often unwilling to grant advances on bills of lading representing merchandise because of its specialized nature. On the other hand, staple commodities can more readily be sold by the banker in the event that he is compelled to press his claim because of non-payment by the borrower.
- ✓ 2. *Negotiation*.—In a general way, the bill of lading may be regarded as a quasi-negotiable instrument, since it can be made transferable from one party to another and so it is either negotiable or non-negotiable. It should be noted that the transferee does not possess legal title which is any better than that held by the transferor. And in this respect the bill of lading differs from a true negotiable instrument. Under a non-negotiable or straight bill of lading, the goods are consigned to a definite party such as William Smith, who may obtain them from the transportation company without even presenting the bill of lading. This type of bill is employed in transactions in which the goods are shipped to a branch house or where the consignee has already paid cash or deposited collateral as a guarantee of

payment. As the merchandise is thus deliverable without documents to the consignee under the straight bill of lading, it offers little security to the banker who has granted the loan. He therefore prefers a negotiable or order bill of lading, which is made out to the order of William Smith or his assigns. William Smith then writes a blank indorsement in which he simply signs his name as indorser, without designating the indorsee. The bill of lading is then given to the banker who retains full title to the goods, since they can be delivered only to the holder of the bill of lading.

3. *Number.*—The transportation company usually issues three bills of lading, but a larger number may be made if necessary. Any copy of the bill of lading has the same force as the original, for if properly indorsed it enables the holder to possess himself of the goods. It is therefore essential for the banker who has granted a loan on a bill of lading to insist upon receiving a "full" set which includes all the negotiable copies issued by the carrier.

4. *Issuer.*—Goods may be transported by either railway companies or steamship lines and so are evidenced by either railroad or ocean bills of lading. The former cover goods being moved generally to a domestic point, while the latter represent merchandise shipped to a foreign port. Railroads also issue "through" bills of lading covering shipments from inland cities to foreign ports, for example, from Chicago to Liverpool via New York. The rights and liabilities of parties under railroad bills of lading have been clearly defined in the "Pomerene" or so-called "Uniform Bill of Lading Act," while the Harter Act, to a more limited extent, has for many years performed a somewhat similar service in the case of ocean bills of lading. The through bill of lading, however, is still the subject of controversy. With the growth of our export trade after the Civil War, American railways issued through bills of lading to facilitate the movement of goods from an inland point to seaboard, thence to a port abroad and even to an interior foreign point of destination. This combination bill found favor among exporters and bankers in the Middle West, and also among merchants abroad, because it brought sellers and buyers in direct contact with one another. It was widely used before 1914 in moving merchandise from the manufacturing centers of the Northeast to the Orient via Pacific ports, and in shipping staple commodities from the agricultural

districts of the Middle West to Europe via the Atlantic seaboard.

The through bill of lading has often proven unsatisfactory, since the railroad company cannot very well give assurance that the goods will immediately be placed on board a particular vessel, especially if consignment is made to a foreign port of destination to which there are only infrequent sailings. The goods may arrive in time at the seaboard, but the shipment may be delayed because of strikes, embargoes and lack of cargo space. These very conditions developed to an aggravated degree after 1914, and so the issuing of through bills of lading via Atlantic ports was practically suspended. There is still strong opposition to them, especially on the Eastern seaboard where banks generally refuse to accept them, save on exportations to the Far East via Pacific ports, unless instructions are specifically given to the contrary. On the other hand, bankers in leading inland cities support their use, and declare that they cannot well finance exports without using the through bill.

The bills of lading thus far considered have been issued by carriers, whether railroad or steamship companies, which usually operate forwarding departments for handling goods at points where reshipment is necessary. At such places a shipper may employ the services of an independent freight forwarding agent, who assembles small consignments and combines them into one shipment. Although this method usually reduces freight charges, it sometimes results in delay until sufficient goods have been gathered to warrant a shipment. Bills of lading issued by freight forwarders give little assurance that the goods will be shipped immediately, and so, according to rule A-1 of the Commercial Credit Conference, these bills should not be accepted by banks negotiating drafts.

5. *Route*.—Theoretically a “direct” shipment of goods to the point of destination is the best method, but in actual practice “indirect” shipment or rather “transshipment” may at times be advantageous to all parties concerned. For example, goods consigned to Riga may be shipped on a steamer bound directly for this port but faster service may possibly be obtained on a vessel going to Hamburg whence the goods may then be forwarded by rail connection to Riga. The Commercial Credit Conference endorses the use of transshipment bills of lading unless

the foreign buyer insists upon "direct" shipment. (Regulation A-2.) Even this term is broadly defined so as to permit the shipment of goods on board a vessel which makes several calls before arriving at the port to which the goods are consigned. As an illustration, if goods are consigned from New York to Athens, the vessel need not make this city its first port of call, but may on the way stop at Gibraltar or Naples which are both on a more or less direct route. Obviously, if the vessel sailed into the Adriatic in order to call at Trieste before arriving at Athens, the shipment could no longer be regarded as direct.

6. *Qualification.*—Bills of lading are said to be clean if the goods are described as received in good order and condition. Under the Harter Act, steamship companies are liable for the condition of the cargo at the time of its delivery. Although the carrier is forbidden to insert in the bill of lading any clauses seeking to nullify his responsibility, permission is given under the Harter Act to make note of any defects in the cargo when received. For example, a carrier, in accepting a consignment of sugar, may mark "ten sacks torn and re sewn," or in acknowledging a shipment of oil, may indicate "five barrels leaking," and the bills of lading are then said to be "foul." In the effort further to limit their liabilities, steamship lines have followed a practice of rubber stamping bills of lading with general notations qualifying the acceptance of goods, even though in apparent good order and condition. For example, bills of lading may be stamped "not responsible for torn bags" or "not liable for leaking barrels" even though the shipments have not been examined to determine whether or not their condition really justified these notations. Although these expressions do not actually state that the bags are torn or that the barrels are leaking, yet if these conditions should develop while the goods are in transit, no claim could be pressed against the carrier. In order to prevent these practices, the Commercial Credit Conference in regulation B-1 insists that "bills of lading shall contain no words qualifying the acceptance of shipments in apparent good order and condition."

7. *Shipment.*—One aspect of the bill of lading which is being actively discussed both in the United States and Great Britain rests upon the interpretation of the term "shipment." This expression may mean that the goods have been actually placed

on board a certain vessel, or may merely signify that the goods have been received by the carrier, without necessarily implying actual placement on a specific vessel. These two conflicting interpretations give rise on the one hand to an "on-board" or "shipped" bill of lading, and on the other to a "received-for-shipment" or "received-for-transportation" bill of lading. Although the "received-for-shipment" bill of lading had been employed in British trade for many years prior to 1914, most steamship companies issued on-board-bills of lading which evidenced that the goods had been "shipped on board the S.S. *Neptune*." The abnormal conditions of the war brought about serious congestion of freight at Atlantic ports. Steamship companies were unable to give a consignor any assurance of the exact time of shipment, or even the name of the vessel which was to move the goods (*Journal of Commerce*, Jan. 8, 1921). Under such conditions carriers drew their bills so as to read: "Received for shipment per S.S. *Neptune* or following steamer." (One authority states that on examination 203 out of 205 bills of lading issued by carriers in the United States contained a "received-for-shipment" clause.—*Proceedings of Eighth Convention of National Foreign Trade Council* (1921), p. 451.) Even after the close of the war this practice continued and, with the collapse of commodity prices in 1920, the received-for-shipment bill of lading was seized by unscrupulous buyers as an excuse for canceling orders for goods, and so the continued use of this type of bill is now threatened (see also *Vietor vs National City Bank*, N. Y. Law Journal, April 24, 1922).

The question therefore arises as to whether the received-for-shipment bill of lading is a valid instrument binding in law. The answer depends upon the legal conception of the term shipment, which unfortunately has been given two different interpretations by American courts. According to *Goldenberg vs Cutler* (189 Appellate Division, 489), "Shipment means that the goods have been delivered to the carrier and his bill of lading issued therefor." Judicial sanction has thus been practically given to the received-for-shipment bill of lading. But in *Mora y Ledon vs Havemeyer* (121 New York 179), the court held that a shipment called for actual delivery on board a vessel, and so an on-board bill of lading alone would be regarded as acceptable.

These opposing views have also been held by two British Courts. In *Marlborough Hill vs Cowan* (1921) I Law Reports, Appeal Cases, p. 444, the Privy Council, in hearing an appeal from an Australian court, was asked to pass judgment on a bill of lading which did not include the usual expression, "Shipped in good order and condition on board the ship *Marlborough*," but instead contained the statement, "Received in good order for shipment by the ship *Marlborough* or any other ship belonging to the shipowners." This document was regarded by the Privy Council as a true bill of lading according to the Admiralty Courts Act of 1860 and also the Bills of Lading Act of 1855, and no distinction was drawn between bills of lading reading either "received-for-shipment" or "shipped on board." The Council expressed the following opinion: "There can be no difference in principle between the source, master or agent acknowledging that he has received the goods on his wharf or allotted portion of quai, or his storehouse awaiting shipment, and his acknowledging that the goods have been put over the ship's rail." (See S. D. Cole, "*Hague Rules 1921 Explained*", p. 48, *Scottish Bankers' Magazine*, vol. 13, no. 50, pp. 110-11; *Commerce Reports*, Feb. 20, 1922, pp. 472-74.)

A directly opposite position was taken by the Court of Kings Bench which, in *Diamond Alkali Export Corp. vs Bourgeois* (Law Reports, Kings Bench, 1921, vol. III, 443; see also, *T. Aron & Co. vs Comptoir Wegimont*, p. 435), rejected the received-for-shipment bill of lading absolutely (for text of decision see appendix). The defendant, a London importer, had contracted to purchase a shipment from the plaintiff, a New York corporation, under the following terms: "September-October shipment from the American seaboard, cash against documents under a confirmed letter of credit opened with a London bank price c.i.f. (cost, insurance, freight), Gottenburg, Sweden." The American corporation delivered the goods to the steamship company which issued a received-for-shipment bill of lading. When the document was presented to the buyer, he refused to accept it and in part justified his action on the ground that the received-for-shipment bill of lading submitted by the seller had not met with the terms of a c.i.f. contract of sale. This view of the defendant was upheld by the court which drew a sharp distinction between a receipt for goods actually shipped on board

a particular vessel and a receipt for goods which at some future time are to be shipped on board either a particular vessel or possibly an unnamed vessel sailing at a later date.

Thus both American and British courts have rendered conflicting decisions on the question of whether or not a received-for-shipment bill of lading is a true bill of lading. Nor is there any agreement on this subject among bankers and merchants. In general, buyers oppose the use of the received-for-shipment bill of lading, since it merely specifies that the goods have been accepted by the carrier, and gives no indication when the goods will actually be placed on board a vessel. For example, a seller may contract to ship goods during October, deliver the goods on October 31 and obtain a received-for-shipment bill of lading as of this date, but the goods may lie on a wharf for days until they are actually loaded on a vessel. While the seller is liable for the safety of the goods until they are delivered to the carrier, the latter in signing a received-for-shipment bill of lading is responsible as carrier only after the goods have been actually placed over the ship's rail. In the interim between delivery to carrier and loading on board, the goods are subject to any number of pre-loading risks, such as loss by fire, or damage by weather exposure, which are covered only to a limited extent by the company's liability as bailee. An opponent of the received-for-shipment bill of lading adds the following objection: "A carrier or his agents may issue a bill of lading no matter where the goods may be located at the time of the issuance of the bill of lading. The goods may be alongside the vessel, or 1,000 miles from the vessel, so long as the carrier acknowledges that he has somewhere or other received them for shipment." (*Nauticus*, Feb. 26, 1921, p. 22.)

The received-for-shipment bill of lading is strongly supported by sellers. They are able to obtain what purports to be a bill of lading immediately upon delivering their goods to the carrier without waiting until actual placement on board ship. The sellers may thereupon present their documents to the negotiating banks all the sooner, and thus payment for the merchandise is expedited. (*Monthly Journal of Liverpool Chamber of Commerce*, November, 1921.)

Bankers are divided in their views on the value of the received-for-shipment bill of lading. A prominent spokesman of the Brit-

ish Bankers Association expressed the view that the instrument is essential in certain fields of international commerce, but urged that a time limit be placed of from 7 to 21 days within which actual shipment must be made. (*Report of Associated Chambers of Commerce*, 1921, p. 39.)

No definite action on the received-for-shipment bill of lading was taken by the delegates at the Hague Conference of 1921. The Rules, in article 3, section 7, recognize the right of a carrier to issue a received-for-shipment bill of lading but fail to define the relationships among the parties to the instrument. The Commercial Credit Conference assumed a more positive stand, for Regulation B-2 states that: "Received-for-shipment bills of lading will be accepted and the date thereof taken to be the date of shipment, and in this case insurance shall cover the shipment from such date of shipment and on whatever vessel carried." As a concession to shippers and bankers, the steamship lines belonging to the Transatlantic Freight Conference agreed first to issue a received-for-shipment bill of lading to a shipper, and later, if he returned the document, to stamp on it an endorsement indicating the date on which the goods have been placed on board a vessel. (See Regulation B-3.)

It may be interesting here to note the status of the received-for-shipment bill of lading in other countries. In Germany a received-for-shipment bill of lading is considered just as acceptable as a shipped bill of lading. The former must specify the name of at least the first vessel on which the goods will probably be transported, as in the clause "Received for shipment in and upon the *S.S. Neptune* or any other subsequent steamer of the X Y Z Line." German law does not regard as valid a bill of lading which reads: "Received for shipment by one of the first steamers of the X Y Z Line." (Shaps, "Das Deutsche Seerecht," 1921, vol. 1, p. 642.) German banks under no condition accept forwarders' bills of lading, even though they certify that the goods have actually been placed on the vessel. (Jacoby in *Bank Archiv.*, June, 1921, p. 247.) In continental Europe and Japan, the received-for-shipment bill of lading is not accepted by negotiating banks, unless instructions are accordingly given.

**III. Marine Insurance Policy.**—The banker is directly interested in the insurance policy, for it indemnifies him, in case

of loss or damage to the goods on which he has extended a loan. There is little need of insuring goods being transported within the United States by rail, since the roads are to a certain extent held responsible for freight handled by them. Ocean carriers are exempt from such liabilities except in the case of extreme negligence, and so goods transported by sea must be covered with a marine insurance policy. This document is defined as a "*Contractual agreement whereby one party (known as the insurer or underwriter) undertakes in return for a stipulated consideration (called the premium) and in accordance with definitely expressed restrictions to indemnify another party (known as the insured or assured) against loss or damage to a definite interest in vessel, cargo, or freight earnings when caused by certain definitely enumerated contingencies*" (Huebner, "Marine Insurance," p. 3).

Policies of marine insurance are issued in various forms, but may be classified according to the following principles:

1. *Statement of Value.—Valued.* This is a policy in which the value of the merchandise insured has been definitely fixed at, say, \$10,000 to cover a consignment of sugar.  
*Unvalued.* No mention is made of the value of the goods which may be determined later in the event of loss.
2. *Name of Vessel.—Named.* In this policy the name of the vessel carrying the goods is specified.  
*Floating.* No mention is made of any particular vessel and the policy covers goods shipped on say, any "Steamer or Steamers."
3. *Time.—Voyage.* This policy insures goods against risks incurred on a particular voyage between two specified ports, as from New York to Rotterdam.  
*Time.* The period of this policy is defined not by the length of a certain voyage, but by a stipulated period of time, as from noon of Jan. 1, 1922, to noon, Jan. 1, 1923.
4. *Shipment.—Blanket.* The blanket policy defines exactly the extent of the risk as to vessel, location, and time, and so the underwriter is able to charge a fixed complete premium based on the estimate of the total value of the goods.  
*Open.* The open or floating policy defines neither the vessel, location nor time, for such details are reported to the un-

derwriters as each shipment is made and the premium is paid on each risk.

**IV. Marine Insurance Certificate.**—In issuing an open policy, the underwriter is acting in about the same capacity as a banker granting a loan by an entry on his books in favor of a customer, who draws against this bank credit by means of checks. In like manner a party who has been given an open policy is permitted to issue marine insurance certificates. These instruments are written on prepared forms evidencing that particular merchandise has been insured under certain conditions in accordance with the terms of a specified open policy. This certificate is a quasi-negotiable instrument, since it can be made payable to the order of a named party who may further assign the instrument by indorsing it on the reverse side (Huebner, "Marine Insurance," p. 235).

The marine insurance policy in recent years has to a large extent been superseded by the certificate, which has found favor among bankers. However, the legality of the certificate at the present time is somewhat doubtful, because of conflicting decisions rendered by British Courts. In the case of *Wilson Holgate & Co.* (1920), 2 Kings Bench Division, p. 9, the court definitely stated that marine insurance certificates "are equivalent to policies, being accepted in this country [England] as policies." This statement is repudiated in *Diamond Alkali Export Co. vs Bourgeois* (see Appendix VI, p. 229). It will be recalled that the defendant in this case rejected a shipment on the ground that the plaintiff had presented unacceptable shipping documents. These included a received-for-shipment bill of lading and a certificate of marine insurance. As previously stated, the court held that a received-for-shipment bill of lading was not a true bill of lading under the terms of a c.i.f. contract. It was further ruled that a marine insurance certificate was not a policy. The court expressed the opinion that such certificate does not contain the terms of the parent policy and so the holder of the former instrument has no means of determining whether the latter has been issued in the proper form.

**V. Broker's Cover Note.**—Another substitute for the marine insurance policy has been the broker's cover note. This instrument was developed during the war when the clerical staffs of insurance companies were reduced, while their business was in-

creased. It was impossible to issue the detailed policies with any degree of speed, and so, instead, recourse was had to cover notes which are mere acknowledgments by the agents of the insurance companies. The further use of these cover notes has been seriously limited by the decisions in *Marrbre Saccharine Co. vs Corn Products Co.* (1919), 1 K.B. 198, and again in *Wilson Holgate & Co.* (1919). In this case it was held that the broker's cover note could not be regarded as an insurance policy and was not good tender under a c.i.f. contract (*Scottish Bankers' Magazine*, vol. 13, no. 50, p. 115).

**VI. Commercial Invoice.**—Another fundamental shipping document is the commercial invoice which determines the conditions to be inserted in all the other documents of the commercial set. The commercial invoice is based on the terms of sale agreed upon by both buyer and seller, and in which the relations between these two parties are definitely fixed. Through the invoice the buyer is able to ascertain whether the seller has observed the terms of the sales contract, and the banker is able to determine whether the quality and quantity of the merchandise will render it satisfactory collateral for the extension of a credit. The invoice should contain an accurate description of such details of the merchandise as price, discount, grade of goods, and number of units. A statement should also be made of the terms of sale which are usually quoted in standard abbreviations accepted by the business community (see Appendix V). A buyer and seller may agree on any one of the following export price quotations:

1 "C." (Cost). This is the lowest quotation and includes only the supplying of the goods ready for shipment at a certain point.

a. "F.O.B." (Free on Board). Thus "F.O.B. Detroit" signifies the loading of the goods on board freight cars at Detroit as evidenced by an inland bill of lading.

b. "F.A.S." (Free along side). "F.A.S. New York" binds the seller to deliver the goods either on the dock or on a lighter along side the steamer and within reach of its loading tackle.

Thus to the original cost of the goods has been added the charge of delivery to a specified point. Beyond this point, items for freight and insurance have not been included in the cost price.

2. "C.&F." (Cost and freight). This price covers not alone the cost of the merchandise but also the charge for ocean freight to the foreign port of delivery. This quotation does not include the cost of insuring the goods against risks which may be encountered in transportation.
3. "C.I.F." (Cost, insurance and freight). The seller may be willing to quote a price including not only the cost of the goods and all charges for transportation, but even the payment of insurance covering the goods on both land and sea to the foreign point of destination.

The above quotations are often modified in order to meet the various possible terms of sale. As indicated above, the leading commercial associations of the United States in 1919 adopted a set of definitions of export price quotations, which have also been accepted by the American Credit Conference.

**VII. Minor Documents.**—In addition to the bill of lading policy of marine insurance and commercial invoice, a shipment may give rise to one or more minor documents.

1. *Consular Invoice.*—This document is required by such countries as the United States and South American republics. A shipper of goods to these countries obtains from the consul at the point of shipment a consular invoice in which practically all the details of the commercial invoice are repeated. The purpose of the consular invoice is to enable the customs officers at the port of entry to classify the goods according to the tariff schedules and to determine the amount of the duty.

2. *Certificate of Origin.*—Countries may enter into a commercial treaty whereby their exports are either entirely or partially exempted from the general tariff duties. The recipients of such privileges are known as "favored nations." In order to take advantage of these reductions, exporters must fill out a certificate of origin which states that the goods are the product or manufacture of the favored nation.

3. "*Non-dumping*" *Certificate.*—A third document often required in order to comply with tariff laws is the non-dumping certificate. Herein the exporter certifies that the invoice price of the goods is not below the current price prevailing in the country of origin. This certificate is required by most of the British colonies in order to prevent the flooding of the local market with goods at prices which home producers cannot meet.

- ✓ 4. *Export Declaration*.—A shipper from any port of the United States must furnish an export declaration containing a complete description of the goods so as to enable the government to compile its statistics on exports.
- ✓ 5. *Inspection Certificate*.—In shipping meat, butter and other foodstuffs, an inspection certificate must be filled out at the request of the importers before the shipment will be allowed to enter certain foreign ports.

6. *Health Certificate*.—A document similar to the above is a health certificate which attests that the shipment is free of disease. For example, the United States forbid the entry of skins from certain sections of the Far East where anthrax prevails, and so shipments of hides and skins must be accompanied by a statement that they are free of anthrax and come from a district where this disease is not prevalent.

The variety of certificates which may be required is endless. Importers may demand certificates of analysis in the case of chemicals, of quality for goods of a certain grade, or of weight in the case of coal. In general, whenever these documents are required, the banker who pays the draft must insist that the exporter has complied with all the conditions imposed by the importer.

The documents described above determine the relations among the various parties to a shipment of goods in foreign trade. The commercial invoice defines the relation between only two parties, the seller and the buyer. The other three major documents likewise involve the buyer and seller but also include a third. The bill of lading brings in the ship owner, the policy of marine insurance adds the underwriter, and the bill of exchange involves the banker.

## CHAPTER III

### MEANING AND CLASSIFICATION OF LETTERS OF CREDIT

I. Need for the Letter of Credit in Foreign Trade.—The needs of any new situation tend to develop a mechanism to meet these special conditions. So in business, the necessities of trade have gradually evolved instruments such as bills and notes to facilitate the exchange of goods. These instruments acquire distinctive features according to whether they are used in domestic or foreign commerce. It is therefore well to view briefly the special needs which arise in foreign trade. A merchant in disposing of his goods at home is confronted with certain problems, but these become more intensified in selling to foreign markets. Because of distance, the marketing of the merchandise usually involves a longer period of time than in the domestic trade. For example, a shipment to the Far East cannot well be made within six weeks and the same amount of time is required for return payment, so at least three months must be allowed to complete the transaction. The seller, or rather the exporter, is usually unable to carry the burden of financing such transactions with his own resources, and so he must rely upon the banker to furnish the necessary credit. Foreign trade is far more dependent upon bank than upon mercantile credit. Differences in law, in custom, and in business morality also are factors which the exporter must carefully consider in dealing with foreign customers. The exporter faces another difficulty in his inability to secure adequate credit information concerning a purchaser who may be located half way around the world. Under these circumstances, the exporter in forwarding his goods has little specific assurance that he will receive payment in all his transactions.

Not all the disabilities are imposed on the exporter, for the importer also has his special difficulties. In buying goods from abroad, he incurs the risk of making payment on delivery of shipping documents without receiving goods of a quality which

he has ordered. As a solution of these problems, business usage has developed the letter of credit. This chapter will present such aspects as meaning and classification of this instrument.

**II. Meaning of the Letter of Credit.**—Before entering upon a consideration of the subject of financing foreign trade through letters of credit, it is well first to view briefly the general theory of bank credit, whether domestic or foreign. The first function of a bank is to study the credit standing of applicants for loans and, if the analysis proves satisfactory to the bank, the next step is to insure the credit of these borrowers up to a certain amount. Theoretically bank credit can be extended in the form either of bank notes which circulate freely throughout the community or of deposit accounts against which checks may be drawn. In the United States the former method has largely given way to the latter, and so this form of bank credit alone need be considered. While a deposit account may be built up by leaving with the bank a sum of money in cash or checks, notes and other credit instruments, the account may also be created through the granting of a loan by the bank to its customer. Whether the deposit account is formed by cash, credit instruments or advances, it represents a claim which is entered on the books of the bank and which the customer can transfer to his creditors. In domestic transactions the borrower who has received bank credit in the form of a deposit account avails himself of it by drawing checks in favor of his creditors.

- ✓ The general principles which underlie bank credit are the same in foreign as in domestic business transactions. In both cases the bank performs the same functions of analyzing credit, practically insuring it in making advances, and transferring claims to it. The difference lies primarily in the instrument used to record this bank credit. Domestic bank credit, as noted ✓ above, can be evidenced by the deposit account on the books of the bank and the pass book in the hands of the customer, while foreign bank credit may be recorded in the form of the letter of credit. Bank credit in foreign trade is often termed “commercial credit,” and so the corresponding instrument is commonly called a commercial letter of credit. The adjective ✓ “commercial” is at times specified in order to distinguish this instrument from the traveler’s letter of credit which will be considered in Chap. V. The letter of credit is an instrument

addressed by one party, usually a banker acting on behalf of another party, to a third party, generally a merchant, whereby this merchant is authorized to draw drafts on the banker who undertakes to honor, that is, accept or pay, them when presented.] In some cases he also reserves the right of cancellation. The deposit account and the letter of credit are thus similar in that they are both availed of by the drawing of drafts. These bills in the case of the deposit account are made by the bank's customer who writes his check, which is after all a form of bank draft, while the letter of credit is utilized by a third party, known as the beneficiary, who draws a bill of exchange on the bank establishing the credit.

Another difference lies in the fact that the deposit account is made available by a check which is really a demand draft, while the letter of credit may authorize the drawing of either demand or time bills. Also the extent to which a bank may expand its credit is limited by different methods under the law. The Federal Reserve Act and also state laws restrict the deposit liabilities of banks by compelling them to carry a cash reserve of a certain percentage of their deposits, while the acceptance liabilities arising from letters of credit are limited to a definite percentage of the banks' capital and surplus.

**III. Classes of Letters of Credit.**—There are several bases according to which letters of credit may be classified.

1. *Security.*—As indicated above, a letter of credit is essentially an authorization by a bank to a beneficiary to draw his drafts on the bank and a promise that they will be honored upon presentation. The undertaking of the bank may be made absolute and so the beneficiary is free to draw his drafts without any conditions. He is then said to have received a "clean" letter of credit (see Form 1). An examination of this form shows that the bank agrees to honor drafts unaccompanied by any documents evidencing title to goods or other security, and so are clean bills. In that case the same term is applied to the credit itself.

The clean letter of credit may be used for transferring funds between a home office of a business house and its foreign agent, or possibly for speculating in foreign exchange. The clean letter of credit is also applied to finance a shipment of goods when for some reason or other the documents are not attached to the

drafts but are forwarded directly to the buyer of the merchandise. This procedure is followed only in dealing with firms of the highest credit standing, for the bills thus unaccompanied by any documents are entirely unsecured.

Most letters of credit are documentary in the sense that the drafts of the beneficiary will be honored only upon his presentation of certain documents which are carefully stipulated in the letter. A clean letter of credit can be transformed into a documentary one by inserting the details of the bill of lading, marine insurance, commercial and consular invoices and other documents as described in Chap. II (see Form 2).

2. *Tenor*.—Letters of credit may be grouped upon the basis of whether they permit the beneficiary to draw his drafts at sight or at a certain tenor such as 60 or 90 days or even longer. If the credit authorizes the making of sight or demand drafts, they are presented to the drawee bank for payment, and if time bills, for acceptance. Drafts are therefore drawn under either cash or acceptance credits.

3. *Amount and Renewal*.—The letters of credit which have been thus far reproduced permit the beneficiary to draw his drafts to a specified amount. When the accredited party has drawn one or more bills equal in the aggregate to this sum, or when the expiration date has been passed, the credit is then said to be exhausted, for under ordinary circumstances it is not renewable. However, a credit may be formulated so as to be renewable or again available to the beneficiary, and it is then described as “revolving.”

This form of credit is well adapted for financing transactions between two firms which have close business relations. If one firm is continually buying from another the same kind of goods such as cotton or sugar in a number of consignments over a period of a year, it is a simpler procedure to establish a revolving credit covering all the transactions than to open a new credit every time a shipment is made. The bank merely issues a letter of credit covering the general conditions of shipment, and, as the beneficiary meets these terms and draws his drafts, the credit is not exhausted but is automatically renewed. A revolving credit of this type, without any further restrictions, would rarely be opened, for it would enable the beneficiary to make shipment, draw his draft, and continue these operations

indefinitely, and if unrestricted, he could drain the resources of the most powerful bank. Therefore a revolving credit almost always contains certain limitations which apply to (a) payment of draft, (b) maturity of draft, and (c) period of time. A credit may again be made available to the beneficiary only after his previous drafts drawn upon the bank are liquidated by the party who has requested the credit.

To illustrate these methods let us assume that the Japanese Exporting Co. has received a revolving credit for \$10,000 and has drawn its sight draft on the X Bank. This institution pays the bill, and, upon obtaining reimbursement from the American Importing Co., informs the beneficiary that the credit is again available. The credit can be renewed more slowly by restricting it to the payment only of time bills. Then the beneficiary must wait until the importer has liquidated the first draft by placing the drawee bank in funds some time before the maturity date. The beneficiary may also be limited in the number of drafts he can draw within a specified period of time. For example, he may be permitted to draw only up to a certain amount in any one week or month. For its own protection, a bank usually limits the beneficiary's drawings to both a certain total amount and also to a definite time limit. In the above illustrations, the credit may be revolving for \$10,000 but the full amount could be limited to \$100,000 in all, or the credit may be revolving for \$10,000 a month but will expire within 6 months and so the total amount cannot under any conditions exceed \$60,000. This does not imply that the beneficiary can always avail himself of the total of \$60,000, for if he does not draw drafts amounting to \$10,000 within any one month the difference cannot be carried over into the following month. The credit is then said to be non-cumulative. In the case of a cumulative credit, the balance unused by the beneficiary is added to the amount against which he can draw during the next month. For example a beneficiary holds a cumulative credit revolving for \$10,000 a month but draws only \$7,000 in February, then in March he may draw \$13,000.

4. *Currency*.—Letters of credit provide for drafts drawn either in dollars or in a foreign money. It has been estimated that nine-tenths of all credits covering international shipments before 1914 were drawn in pounds sterling. With the disloca-

tion of England's financial machinery due to the war and with the reorganization of America's banking system under the Federal Reserve Act, sterling credits declined while dollar credits increased in use.

An American bank engaged in financing international commerce must be in a position to open credits not alone in dollars, but also in foreign currencies such as pounds, francs, and marks. The American bank must either operate branches in foreign countries or carry accounts with foreign banks. The letter of credit issued by the American bank will then call for the drawing of drafts up to a certain number of pounds sterling either on a foreign branch or, more usually, on a correspondent bank in London (see Form 3). A letter of credit drawn in foreign currency thus may involve another institution, namely, the accepting or paying bank. In dollar credits, the bills are generally paid or accepted by the American bank which has issued the letter of credit.

5. *Transferability*.—A letter of credit ordinarily is available to the beneficiary only and so cannot be transferred to a third party. Any credit can be made assignable by adding the expression "or order." The credit would then read, "We hereby authorize you or order to draw your drafts on us." Banks do not usually permit a beneficiary to assign his credit to another party unless the importer gives his consent. Such assignments have often proved unsatisfactory as the assignee has not always delivered the exact merchandise ordered by the purchaser.

6. *Cancellation*.—In the letters of credit thus far considered, the issuing bank has definitely assumed the engagement to honor the drafts of the beneficiary provided he meets certain conditions as to shipping documents and draws his bills before a specified expiration date. Prior to this time, the bank cannot rescind its undertaking without the consent of the beneficiary and so the credit is said to be "irrevocable." A credit can be made revocable simply by adding, after the statement of the bank's undertaking to honor drafts, the expression "unless previously canceled." Letters of credit are usually irrevocable, for most banks are unwilling to rescind credits which they have once issued and some banks even refuse absolutely to open revocable credits.

7. *Confirmation*.—The significance of the term "confirma-

tion" can best be explained by referring to the letter of credit forms described above. Letter 2 represented a dollar credit opened by an American bank. Letter 3 was a sterling credit opened by an American bank, the drafts to be accepted and paid by a British institution which debits them on the account of the American bank. A sterling credit can also be opened in favor of the exporter by the American bank requesting the British correspondent to issue its own letter to the beneficiary. The second method would have to be employed if the beneficiary were unwilling to take an obligation issued by the American bank and desired instead a credit from an institution in his own country. Between these two methods of opening a sterling credit is a third by which the American bank issues its own letter in sterling and requests its British correspondent to "confirm" this credit to the beneficiary.

What is the significance of this act of confirmation? This expression has not as yet been defined by American or British Courts, so its meaning must be sought elsewhere. The Century dictionary defines the verb "to confirm" as "to add strength." This definition expresses exactly the meaning of the term confirmation as accepted by most banks. They generally hold that a bank which confirms a credit is adding its guaranty to the obligation. As stated above a bank may issue either a revocable or an irrevocable credit. The former may be nullified by the issuing bank at will, but the latter document can be rescinded only with consent of the beneficiary. Both credits may be sent to the beneficiary directly or through a second bank. This institution without assuming any liability itself simply conveys the information that a credit has been opened by the American bank. These revocable or irrevocable credits of the American bank are then said to be unconfirmed by the British notifying or advising bank.

However, this institution may be requested to add its confirmation or guaranty to the credit which then becomes confirmed. Naturally a credit revocable by an issuing bank would never in practice be confirmed by the notifying bank, for only an irrevocable credit could be further confirmed with safety. Hence from this discussion it becomes clear that letters of credit are classified as (a) revocable by the issuer, unconfirmed by the notifier; (b) irrevocable by the issuer and unconfirmed by the

notifier; (c) irrevocable by the issuer and confirmed by the notifier. There is no real distinction between the meaning of the terms "irrevocable" and "confirmed" as applied to credits. They both signify that the beneficiary has received an absolute guarantee of payment by a bank. The two terms refer, however, to two different parties. The term "irrevocable" applies to the issuer of the letter of credit and the expression "confirmed" to the adviser.

There is considerable uncertainty among banks and merchants as to whether a confirmed credit implies an obligation upon one or upon two banks. It is held by some banks that when an exporter receives a confirmed credit, he is holding only the obligation of the advising bank. For example, let us assume that a British bank has opened an irrevocable credit in favor of an American exporter. He rejects the credit and insists upon one confirmed by a bank in his own city. The British bank then requests this American bank to issue a confirmed letter of credit. In the event of the failure of the American bank which has confirmed the credit, can the exporter in seeking payment look to the British bank whose irrevocable credit he has rejected? The supporters of this view point to the significance of certifying a check. Certification transfers the liability from the drawer to the bank and if a check has been certified at the request of the payee, he has no claim upon the drawer in the event that the bank fails. Likewise it is held that when a letter of credit issued by one bank is confirmed by another, the latter institution has substituted its obligation in place of the credit of the former; consequently, if the confirming bank fails, the beneficiary has no redress against the bank which has opened the credit.

This contention, however, loses sight of the fundamental principle of confirmation. When a bank confirms a credit it is not substituting its own credit in place of that of the opening bank, but rather it is adding its guarantee to the obligation of that bank. Confirmation is not analagous to the procedure of certification but rather to the act of endorsement. When one party endorses a note it strengthens the instrument and transforms it from one to two name paper.

Only in recent years have credits opened by one bank been confirmed by a second institution. American banks operating

under the National Bank Act were not empowered to accept drafts and consequently were unable to open their own credits. Since most letters of credit covering American imports and exports were issued by British banks known all over the world, American exporters of cotton, grain and other commodities were fully satisfied with receiving the letters of these British institutions and did not ask for confirmation by American banks. They were usually not interested in financing foreign trade and so their confirmation would have been of little or no avail. With credits emanating from only one source, naturally all letters were either revocable or irrevocable, or what then amounted to the same thing, unconfirmed or confirmed. However, in this connection the confirmation was interpreted as referring to the act of the bank in endorsing the credit of the importer himself.

The outbreak of the war altered completely the technique of financing foreign trade. The nature of our exports changed entirely, for England, France and their Allies demanded machinery, ammunition, war equipment and foodstuffs in well-nigh unlimited amounts. These orders were placed with American manufacturers and merchants who before had never given thought to foreign trade and who knew little or nothing of commercial credits. They were not satisfied with an irrevocable credit opened in their favor by a British bank but insisted upon the added assurance of an American bank. The latter was then called upon to confirm the credit of the British bank, and so the irrevocable-confirmed letter of credit resulted. There is no doubt that this type will continue to operate as long as American banks engage extensively in financing foreign trade and as long as the dollar retains its place as the most stable means of international payment.

8. *Negotiation*.—A letter of credit authorizes the beneficiary to draw drafts, and usually contains a clause in which the issuing bank agrees with any bona fide holder of the drafts that they will be duly honored on presentation. The beneficiary is permitted to negotiate his drafts with any banker who offers to pay the highest rate of exchange. This type which thus permits free negotiation is called a general letter of credit. On the other hand if the beneficiary is allowed to sell his drafts to only one or more specified banks, the communication is called a special letter of credit. ✓

9. *Number.*—A letter of credit may be either original or supplementary. The former may serve as the basis for the issuing of the latter. For example, an exporter who has received a credit may request the bank to open a supplementary, or, as it is sometimes called, ancillary credit in favor of a third party, who may be a sub-contractor or a manufacturer furnishing goods to the exporter. In this case the original beneficiary is the opener of the credit and the sub-contractor or manufacturer becomes the beneficiary.

10. *Location.*—Credits are sometimes opened by a buyer in favor of a local seller in a transaction where the latter demands protection against cancellation of the order by the former. A number of firms which have experienced the advantage of holding irrevocable letters of credit in foreign trade seek to obtain similar protection against cancellation in their domestic business. By receiving irrevocable letters of credit, the seller is thus given a guarantee from the issuing bank that the buyer cannot repudiate his part of the contract of sale. The use of the letter of credit in domestic trade is limited, and the instrument finds its widest application in international commerce.

11. *Financing Method.*—Letters of credit issued by American banks are used largely to finance the movement of goods to and from the United States. American letters of credit may also be employed to facilitate the flow of goods between two foreign countries, a procedure which is described as indirect, rather than direct, financing. For example, a New York bank may establish a letter of credit in favor of a Brazilian beneficiary, at the request of a Cuban merchant to finance a shipment of coffee from Rio de Janeiro to Havana.

From the above discussion, it is evident that letters of credit may be issued in many forms and combinations. These forms may in part be classified as follows:

Basis of Classification	Classes of Credits
1. Security	{ clean documentary
2. Tenor	{ cash (demand) acceptance (time)
3. Amount and renewal	{ fixed (non-revolving) revolving

4. Currency	{ dollar foreign
5. Transferability	{ assignable non-assignable
6. Cancellation	{ revocable irrevocable
7. Confirmation	{ confirmed unconfirmed
8. Negotiation	{ general special
9. Number	{ original ancillary
10. Location	{ domestic foreign
11. Financing method	{ direct indirect

**IV. Parties.**—Reference has been made to the various parties to the letter of credit, and as they will frequently be mentioned in subsequent chapters, it is well briefly to group them together.

1. *The opener* is the importer of the merchandise, who requests his bank to issue its letter of credit.

2. *The beneficiary* of the credit, or the accredittee, is the exporter who is shipping the goods.

3. *The issuer* is the bank which gives its letter of credit and is also known as the credit opener when it asks a second bank to issue a letter.

4. *The acceptor* is the bank accepting the drafts of its correspondent which has issued a letter of credit in foreign currency.

5. *The notifier* is the bank which informs the beneficiary of the opening of the credit. This bank may also be described as the adviser.

6. *The negotiator* is the bank which purchases the drafts of the beneficiary. The notifier is usually also the negotiator.

**V. Advantages.**—At the opening of this chapter consideration was given to the special problems which arise in the financing of foreign trade. The following discussion of the letter of credit indicates in a general way how the operation of this

instrument to a large extent solves these problems. The advantages of the letter of credit may now be briefly summarized:

- ✓ 1. The burden of financing the transaction is transferred from the merchant to the bank. Neither the seller nor the buyer is compelled to extend credit, for this function is performed by the latter's bank.
- ✓ 2. The determination of the standing of the importer is made by the bank opening the credit. When a bank issues a letter of credit on behalf of an importer it is practically giving its opinion concerning the credit of the buyer as expressed in the amount stated in the letter. The bank is in a better position to judge the standing of its own customer than the exporter who is usually located in a distant country.

These two advantages apply only to the financial aspect of the letter of credit, but the instrument possesses also commercial advantages to both importer and exporter.

3. The importer to a certain extent is assured that he will be called upon to make payment only upon receiving the goods which he has ordered, for the exporter must deliver documents which comply exactly with the terms of the credit.
- ✓ 4. The exporter who receives the letter of credit can feel confident that, upon the delivery of the proper shipping documents, he will obtain cash or its equivalent in the form of drafts easily negotiated. Especially is this true if he insists upon a confirmed-irrevocable credit which practically insures him against cancellation by the buyer, the buyer's bank and even the notifying bank, if he fulfills all the necessary obligations.

## CHAPTER IV

### OPERATION OF LETTERS OF CREDIT

The previous chapter has considered the meaning of the letter of credit and has presented a classification of the various forms which the instrument may assume. This chapter will trace the operation of the following commercial credit transactions:

1. Operation of a dollar credit.
2. Operation of a sterling credit.
3. Operation of a credit opened by a bank without a foreign department.
4. Operation of a credit opened through an advising bank.
5. Operation of credits which may be cancelled.

**I. Operation of a Dollar Credit.** 1. *Applying for a credit.*  
—In order to present in logical sequence the successive stages of handling a commercial credit an actual transaction will be used as a basis. Let us assume that the American Importing Co. approaches the X Bank where it carries its account and requests this institution to issue its letter of credit in favor of the Japanese Exporting Co. The bank first requires the American firm to present its requisition in a formal document known as an application for letter of credit (see Form 4). ✓

The application is a document addressed by an importer to a bank in which the latter is requested to issue its letter of credit in accordance with certain carefully specified conditions. Most applications require the importer to furnish detailed information such as tenor of draft, content of bill of lading, insurance policy, commercial invoice, and other documents, method of shipment and the general nature of the transaction between exporter and importer. From these facts the bank determines whether or not it is advisable to finance the importer's undertaking. If it meets with the approval of the bank, the details contained in the application then provide the facts necessary for filling out the credit letter itself. The application is of special service to the importer, for it protects his interests by definitely presenting the terms concerning shipment, merchandise and documents, ✓

which the bank must observe in issuing the letter of credit and in finally paying the drafts drawn by the beneficiary.

An application for a commercial credit must be scrutinized by the bank with the same care which is exercised in analyzing a request for a loan. As indicated above, the bank is extending its credit in the one case in the form of a letter of credit, and in the other usually in the form of a deposit account. A foreign credit like an ordinary domestic loan may be secured by requiring the applicant to deposit collateral such as stocks or bonds. These credits may be unsecured and the bank then depends entirely upon the personal credit of the importer. The bank is thus confronted with the problem of analyzing the standing of the applicant and so the foreign department of a large bank has recourse to credit files.

The credit risk of the importer is determined in about the same manner as that of the ordinary borrower, for both are usually conducting their business in the same country and often in the same city as the bank. It is therefore able to investigate the credit standing of the importer by resorting to the usual sources of credit information, such as property statements showing the assets and liabilities of the borrower, reports of Dun, Bradstreet and other commercial agencies, and reports of banks and business houses which have had business dealings with the applicant for a credit. In determining the borrower's rating, the bank lays special emphasis upon the current data to be found in the records of its various departments. It is essential to know the liabilities which the importer has already assumed in dealing with these departments. This information showing the importer's account with the bank is summarized in a statement blank known as the "offering" slip or ticket. This form usually presents the following data: (1) exchange purchased which includes drafts drawn by the applicant and bought by the bank, (2) obligations discounted, whether notes of the importer or bills and notes receivable from his customers, (3) renewed and time loans advanced to the importer by the bank, (4) drafts accepted by the bank under commercial credits or under acceptance agreements to cover exports made by the applicant, (5) balance carried with the bank computed as an average over a month or a year and also at the present time.

This offering slip may be prepared in two ways. The data

may be compiled by a "line" desk from central files in which all credit information is assembled. Another method is to circulate the offering slip among the various departments which possess the figures in their respective files. When the slip is completely filled out, it serves as a basis for determining the line of credit or maximum amount which the bank will extend to the importer. If this amount is not exceeded by the importer's application, the request for the credit is then granted.

2. *Contracting for a Letter of Credit.*—The contract is an agreement signed by the importer in which he acknowledges the issuance of a letter of credit, promises to compensate the bank for all disbursements made in his behalf, agrees in view of such advances to give the bank adequate security and consents to the waiving of certain rights. This contract is a form prepared by the attorneys of the bank and is carefully drawn so as to safeguard the interests of the bank issuing the letter of credit. In actual practice its terms are seldom invoked, but serve as a protection to the bank against possible losses. This agreement may take the form of an ordinary letter addressed by the applicant for the credit to the issuing bank, or it may appear as a formal contract between the two parties (see Form 5). The contract usually opens with a statement in which the importer acknowledges the issuing of the bank's letter of credit and refers to the copy printed on the reverse side. This introductory portion also contains the stipulation that the applicant agrees fully to the terms contained in the obligation which follows. At this point the legal capacity of the importer is defined either as the applicant who is seeking the credit, or as the guarantor who is giving the assurance of payment, or as the obligor who is bound by the terms.

The method of reimbursing the bank varies with the class of credit to be issued. Letters of credit may be grouped as dollar or foreign, depending upon the currency in which they are opened, or as sight and acceptance credits according to the tenor of the drafts. If a dollar sight credit is opened, payment is made by the importer in New York in cash at the office of the issuing bank. In the case of dollar acceptance credits the bank must be placed in funds at a time immediately before the date on which the acceptances will eventually mature. As a rule the importer is expected to anticipate the payment

of these acceptances at least one day before their maturity. In some forms of contracts the date is not specified and the bank is thus able to vary the time in accordance with the credit standing of the importer. If the drafts are drawn in sterling or in some other foreign currency, they may be settled either by remittances in the form of cable transfers or checks. As an illustration, if a London bank has agreed to honor drafts drawn in sterling, it is necessary for the American bank which has requested the opening of this credit to furnish the funds to meet the payment. The American bank in turn requires the importer to supply it with these funds. If the importer chooses to make payment through cable transfers these are bought at the rate of exchange current on the day of actual transfer. If, on the other hand, he elects to meet his obligations in London through checks it is necessary for him to place the American bank in funds at a time soon enough to permit the sending of these sight drafts by mail to the place of payment, such as 10 days in the case of sterling credit.

The contract also makes provision to reimburse the bank for its services other than the payment of drafts. For issuing letters of credit, the bank receives a commission which is usually specified in the contract. The commission may be computed either on the full amount of the credit or on only the portion actually used by the beneficiary. For example, a credit may be opened for \$10,000 but the beneficiary, for some reason or other, avails himself of only \$5,000 and so the opener need pay at the rate of, say,  $\frac{1}{4}$  per cent of \$5,000 or \$12.50. As the overhead cost of handling a credit is almost the same for a small as for a large credit, the contract may specify that, whether or not the full amount is utilized, a minimum commission of, say,  $\frac{1}{4}$  per cent will be charged by the issuing bank.

Under the terms of the contract it is sometimes specified that the insurance is to be effected either in New York or at the place of shipment and therefore the cost must be carried either by the importer or exporter. It is, of course, to the interest of the bank to see that the insurance is carried in companies whose assets are sufficient to assure payment in event of any losses. Therefore the contract frequently permits the issuing bank to name the insurer. At times this choice is left with the importer but a qualifying clause is usually added that this company must

be satisfactory to the bank. The name of the insurance company is seldom specified in the contract, but a few banks call for detailed information concerning the name of the company, the number of the policy and the date of issuance. In the event of loss, the bank is entitled to the proceeds and therefore the agreement mentions that the loss is payable to the bank directly or states that it is payable to the order of the bank. Some contracts even provide that the importer must indemnify the bank if the insurance company fails to make satisfactory reimbursement in case of loss. The contract may include statements on more or less controversial subjects as the acceptability of marine insurance certificates, received-for-shipment bills of lading and partial shipments.

The opener is usually asked to waive certain claims. The issuing bank and its correspondent abroad are not to be held responsible for the character of the goods, genuineness of the documents, validity of the insurance, or errors in cabling. The opener of the credit must usually recognize the issuing bank as the owner of the imported goods wherever located, until all obligations are paid by the opener. He is often required to furnish the bank with cash or collateral as a pledge that the obligations assumed by the bank will eventually be met.

3. *Issuing of Letter.*—With the application approved by the bank and the contract signed by the importer of the goods, the credit is opened and the letter is then issued. The form in which the instrument is drawn varies according to the practice of the issuing bank. In the past these documents have been prepared by the attorneys and the officers of each bank and so there has been little effort at uniformity. Similarity can be noted here and there wherever a bank has copied some of the desirable features of the forms employed by other institutions. The author made a study of the forms of leading American banks with a view of deriving principles which might be of advantage in attaining greater standardization. The results of this survey were published in the *Federal Reserve Bulletin* for April, 1921, pp. 410-15. In its general form the commercial letter of credit possesses all the characteristics of the ordinary business letter. The name of the beneficiary to whom the letter is directed appears in the usual place of the address. The date, name and location of the issuing bank are all written above, and

the signature of one or more of its officers appears below. While letters of credit vary extensively, they all generally contain an agreement on the part of a bank to honor the drafts of the seller of the goods and also a statement of the conditions which he must observe. In most letters of credit, the undertaking of the bank is expressed first, in an authorization to the beneficiary to draw drafts for a certain amount, and second, in a general promise to all bona fide holders of these bills that they will be duly honored. The credit also describes the required documents and states the time within which the conditions must be fulfilled.

Let us assume that an irrevocable letter of credit is issued by the X Bank to finance the shipment of silk from Japan as mentioned at the beginning of this chapter. According to the terms of sale between buyer and seller, the letter is irrevocable and permits the drawing of drafts in dollars.

The letter of credit may now be forwarded by the issuing bank directly to the beneficiary, but the bank takes this step only upon such instructions from the importer. Usually the bank delivers its letter of credit to the importer who in turn transmits it to the accredited party. When the beneficiary is advised by cable, he does not wait for the arrival of the credit letter itself, but immediately proceeds to prepare his goods for shipment.

A bank exercises special care in disposing of the copies of its credit letters. It retains one copy for its own files, and gives another to the importer, so that he may verify the details which the bank has inserted in the original letter to the beneficiary. This letter is usually sent as a single copy but a duplicate may also be forwarded. A number of banks follow the latter policy in order to be sure that the second instrument arrives at its destination, in the event that the first one is lost or delayed while in transit. This course is often taken by banks in forwarding credits to parts of the world where mail communication is uncertain. The bank then indicates clearly that the form is not the original but merely a duplicate. This duplicate usually bears a stamp stating that it is non-negotiable. This precaution is taken to prevent the beneficiary from misusing the instrument by presenting his drafts and the letter to one bank and repeating the same operation at a second bank. Because of the possibility of such frauds, many banks issue their letters of credit only in single form. In case of the disappearance of the original letter,

these banks issue a duplicate only when the importer furnishes a bond covering twice the amount of the credit, so as to indemnify the bank against possible loss. This is an imitation of the practice which American banks follow in insisting upon double indemnity before issuing a duplicate certified check when the original has been lost.

4. *Presenting of Documents.*—One purpose of the letter of credit is to enable the exporter to negotiate or sell his drafts covering the goods which he is shipping. If the exporter has a good credit standing in his own community, he experiences little difficulty in disposing of his drafts with the banks in his locality, but if he is not well known he can use the letter of credit as an aid in selling his drafts. The instrument, as mentioned above, contains the definite promise of the issuing bank that it will honor the drafts drawn by the importer. He therefore fills out his draft, indicates that it is drawn under the authorization of the letter of credit of the X Bank, and offers the bill to a bank which has agreed to buy it. The bank compares the shipping documents attached to the bill with the terms of the letter of credit. The importer and his bank which issues the credit seek every assurance that the bank negotiating the draft will make payment to the beneficiary only if he has observed the conditions of the credit. In order to obtain this assurance, some American banks place on their letter of credit the following statement: "Your negotiation of any draft or drafts under this letter of credit will be considered a guarantee to the issuing bank that the terms and conditions therein have been fulfilled." The negotiating bank is thus compelled to sign a guaranty which certifies that the terms of the credit have been observed. This procedure operates to the advantage of the credit-issuing bank which can hold the negotiating bank liable for discrepancies between the terms of the letter of credit and the shipment of the exporter.

However, the insistence upon such guaranty tends to limit the negotiation of the credit and the exporter may encounter difficulty in finding a bank which is willing to buy his drafts if required to sign such an obligation. This objection is overcome by one bank in exacting the guaranty not from the negotiating bank but from the beneficiary himself who is compelled to sign the following statement:

"We beg to hand you the undermentioned drafts with shipping documents attached for negotiation. We herewith declare that these drafts and documents have been made out in strict conformity with the terms concerned and agree to hold ourselves responsible therefor."

5. *Negotiating of Draft.*—If the conditions have been observed by the exporter, the bank then negotiates his draft at the rate of exchange which it is quoting for bills drawn on New York. Under a general letter of credit, the exporter is free to negotiate his draft with any bank and so he is able to secure the most favorable rate of exchange. A special letter of credit limits the beneficiary to one or more negotiating banks. They are usually required to record on the reverse side of the letter of credit, either special or general, certain details concerning the drafts, such as date of payment, name of negotiator, place of negotiation, and amount in words and figures. If a negotiating bank fails to enter the details of the draft which it has purchased, other banks are thereby unaware that the exporter has already availed himself of the credit, and if dishonest, he could easily take advantage of this omission by presenting his letter and a second set of shipping documents to another bank which may be induced to negotiate the draft. In order to guard against such losses due to the carelessness of negotiators, some banks insert in their letters of credit a statement that the amount must be indorsed thereon, and the negotiation of any draft is considered a guarantee that such indorsement has been made. At times it is difficult to enforce this requirement, for credits are often cabled, and the exporter draws his drafts and sells them long before he receives the actual letter of credit.

An exporter may avail himself of the credit by drawing more than one draft. The issuing bank generally asks the negotiator of the last draft to attach it to the letter of credit and to return both. Banks desire the return of their credit letters to prevent them from falling into the hands of parties who would be liable to use these instruments as a means of committing fraud. Unfortunately negotiating banks often fail to observe this practice. Let us assume that the Japanese exporter has sold his drafts to the Y Bank of Tokio. It may in turn sell the drafts to another bank, and in fact these bills may pass through several hands. As a matter of practice, an exporter does not attempt to market his bill directly but prefers to give it to a bill broker

whose business it is to find a purchaser. The bank which finally negotiates the draft sends a copy of the bill of lading and the consular invoice direct to the X Bank which has issued the credit, and forwards to its correspondent in New York the complete set of shipping documents including the original bill of lading and commercial invoice together with the draft. It is also customary to send a duplicate draft known as a second of exchange to which are attached all remaining copies of the documents.

The drafts are presented to the drawee bank either for payment or for acceptance. Before paying or accepting these drafts, the X Bank compares the accompanying documents with the terms of the credit to determine whether the beneficiary has complied with the required stipulations.

The bill of lading, invoice and other shipping documents are usually filled out in the name of the X Bank as credit issuer, or its order. Upon paying sight drafts, the bank receives the documents and becomes the actual owner of the goods. These are released to the importer only if he reimburses the bank for the amount of drafts, commission for the credit and other charges. In the case of an acceptance credit, the bank receives the documents merely upon writing its acceptance across the face of the drafts. By this act the bank agrees to pay the drafts of which the maturity may be two, three, or four months hence. Upon its acceptance of the drafts, the X Bank delivers the documents to the importer so that he may obtain possession of the goods. The bank usually requires him to recognize its title to the merchandise in an instrument known as a "trust receipt." The nature of this document and the further dealing between the importer and the bank will be considered in Chap. IX. The shipping documents are at times delayed by the negotiating bank or are mailed on a slow steamer, and so the merchandise arrives first. The goods are not supposed to be removed from the wharf until the relative shipping documents are delivered to the steamship company and to the collector of the port of entry. However, if the goods remain on the dock too long, they become subject to wharfage charges or are eventually placed in "general order" which involves additional penalties to the importer. To avoid this situation, the bank which has issued the credit addresses to the steamship company a communication reading as follows:

JOHN JONES, Agent,  
International Mercantile Marine Co.,  
New York.

DEAR SIR:

Kindly deliver to The American Importing Company, or their order, shipment of raw silk which arrived per *S.S. Neptune*:

The relative documents have been delayed in the mails, but we guarantee their production to you as soon as received.

In consideration of your complying with our request, we hereby agree to hold you harmless from all consequences.

Yours truly,  
X BANK.

Another letter somewhat similar in content is addressed to the collector of the port whose consent must be secured to enable the importer to enter the goods. In the communication the bank is practically guaranteeing the performance of a certain act, in this case the production of certain documents by the beneficiary. In a way, banks operating under the National Bank Act are not legally permitted to enter into these obligations which are clearly guarantees (see p. 46). However, the procedure is an essential part of their daily business and must be followed in order to prevent general order charges to their customers. There is little possibility of loss to the bank, for it usually requires its customers to sign a counter guaranty in which the latter agrees to indemnify the bank against any damages or claims.

**II. Operation of a Sterling Credit.**—In the above description, consideration has so far been given only to the operation of a dollar credit. A credit in sterling or in another foreign currency is handled in a somewhat different manner. Although the issuing bank may transmit the letter to the beneficiary, at the same time it must advise this fact to its British correspondent on whom the draft will be drawn. It is customary to send a copy of the letter of credit to the British bank which is acting as drawee. The Japanese bank which negotiates the draft sends one set of shipping documents to the X Bank as the credit issuer but another set with the draft must be forwarded to a London correspondent for presentation to the drawee bank. This institution is thus in possession of duplicates of the credit letter and of the shipping documents, and so is able to compare them before honoring the draft.

**III. Operation of a Credit Opened by a Bank Without a Foreign Department.**—In describing the operation of a credit, it has been assumed that the importer is a customer of the bank issuing the letter of credit. Banks also issue letters on behalf of the customers of interior banks which do not conduct foreign departments. For example, a wholesale grocery firm of Kansas City, desiring to import sugar, will request a local bank to arrange for the opening of a credit through its New York correspondent. It will usually perform this service if the balance of the interior bank is sufficient to cover the amount of the credit. The Kansas firm would probably be unable directly to induce the New York bank to open the credit, but this service is obtained because the inland bank is willing practically to guarantee the obligation of the importing house.

This procedure raises an interesting legal question, since national banks are forbidden by law to act as guarantors. In *Bowen vs Needles* (94 Fed. 927) the court held that "no banking corporation has the power to become a guarantor of the obligations of another, or to lend its credit to any person or corporation unless its charter or governing statute expressly permits it." National banks are regulated by the National Bank Act and the Federal Reserve Act, neither of which expressly confers the right to guaranty. The National Bank Act authorizes the discounting of notes, drafts and bills of exchange, and the Federal Reserve Act permits the accepting of drafts under certain limitations. But these grants of power can scarcely be interpreted to mean that a national bank may act as guarantor.

However, the organization of the American banking system practically forces the recognition of the right of an interior bank to guarantee the credit of a local importer. In the United States there are about 30,000 banks but only a few conduct foreign departments or maintain relations with correspondents abroad. Letters of credit issued by the other banks would have little value outside of the United States. One purpose of a letter of credit is to enable the beneficiary to sell his drafts, but an exporter in Yokohama would encounter considerable difficulty in negotiating drafts drawn under a letter of credit issued by a Montana or Wyoming bank. This problem seldom confronts the holder of a letter issued by banks of Great Britain, Japan and the more important European countries where the

financing of foreign trade has been concentrated in a few large banks with numerous branches. A British importer desiring to open a credit simply applies to the local branch of a London bank, and as he is usually a customer, his request is generally granted.

American banks have been practically forbidden to operate domestic branches and so in the United States a system of small independent banks has been developed. As these institutions do not operate foreign departments of their own, the problem therefore arises how an American importer situated in the interior can obtain a letter of credit. He could, of course, apply directly to a large city bank but it would not have any knowledge of his credit standing, and so the application would probably be denied. The Federal Reserve Board, realizing these difficulties, in 1921 suggested a possible procedure which would legally permit an inland bank, acting in behalf of its customer, to open a credit with its city correspondent without entering into an *ultra vires* transaction or one beyond its legal power. The Board proposed the following arrangement: "The New York correspondent agrees as agent of the interior bank to issue a letter of credit for the account of the interior bank's customer, the letter to be issued in the name of the New York correspondent, but in issuing it, the New York correspondent is acting, as a matter of fact, as agent for an undisclosed principal, namely, the interior bank. The interior bank's name will not appear in the letter of credit, but its New York correspondent may look to it for reimbursement under the collateral agency agreement, not conditionally upon the failure of the customer to put the issuing bank in funds but directly and unconditionally as the real issuer of the letter." (Opinion of Federal Reserve Board, on Authority of National Banks to guaranty letters of credit, *Federal Reserve Bulletin*, April, 1921, 547.) In accordance with this suggestion, the city bank asks the inland correspondent to sign instruments authorizing the appointment of the former as the agent of the latter (see forms 6 and 7, Appendix, pages 206 and 207).

**IV. Operation of a Credit Opened Through an Advising Bank.**—Attention has thus far been directed to the operation of a dollar and a sterling credit opened by an American bank whether for its own customer or for an interior bank. In every

case the issuing bank dealt directly with the beneficiary. As this type of letter is issued to cover a shipment of goods from abroad, it is popularly described as an "import" letter of credit. This term may quite properly be applied from the viewpoint of the buyer, but on the other hand, to the seller the instrument is really an export letter of credit. Every import of goods is at the same time an export, and so it is somewhat misleading to style letters of credits either as "import" or "export" forms. Theoretically there is only one kind of bank credit extended to finance movement of goods. This credit may, however, be evidenced in letters of various forms. As explained in Chap. III, a bank may issue its own letter, or may open the credit with a foreign correspondent which then issues the letter. The operation of the type of credit is about the same as described above. A somewhat different situation arises when a bank requests its correspondent not to issue its own credit but merely advise the credit of the former to the beneficiary.

The credit may be irrevocable by the issuing but unconfirmed by the advising bank. It may be asked to add its confirmation to the credit of the issuing bank, and so the communication addressed to the beneficiary informs him of the opening of a confirmed, irrevocable credit. The communication by which the notifying bank transmits the information concerning the opening of a credit to the beneficiary is often called a letter of credit. It is really not a letter but merely an advice of a credit, for the credit is extended not by the notifying bank but by the original opening bank, which alone can issue the letter of credit. While a letter of credit can usually be issued either in irrevocable or revocable form, advices can be written as: (1) irrevocable confirmed, (2) irrevocable unconfirmed and (3) revocable unconfirmed. Letters of credit are usually irrevocable, but no such generalization can be applied to advices. Letters of credit are fairly uniform in content, but advices are issued in confusing varieties.

*1. Request for Advice.*—Let us assume that the British Importing Co. of Liverpool has purchased cotton valued at £10,000 from the American Exporting Co. of New York. The latter insists upon an irrevocable letter of credit confirmed by an American bank, and so the British Importing Co. requests the Y Bank of London to arrange for this type of credit. As the

two banks are continually engaged in mutual business relations, these are often governed by a formal contract or agreement. This agreement in a general way describes the method of performing various inter-bank services, including the opening of credits. While an agreement prescribes conditions which apply to the opening of all credits, it cannot specify the details. These are furnished to the issuing bank in the form of a telegraphic letter of credit. In the illustration under consideration the Y Bank of London sends the X Bank of New York a cablegram which reads somewhat as follows: "Have opened irrevocable credit No. 1000 please confirm to American Exporting Co. £10,000 three months' sight drafts on ourselves bills of lading consular and commercial invoices, insurance policies, No. 2 middling cotton, c.i.f., Liverpool account British Importing Co. credit expires March first."

In order to correct possible errors which may arise in cabling this credit, it is customary for the requesting bank immediately to send the issuing bank a letter which reaffirms all the facts already stated in the cablegram. This letter may read as follows:

London, England.

Jan. 2, 1922.

X BANK,

100 Nassau Street,

New York, N. Y.

Dear Sirs:

We confirm our cable of Dec. 1, 1921, opening for account of British Importing Co. a credit in favor of American Exporting Co. for the sum of (£10,000) Ten Thousand Pounds available by their drafts on us at three (3) months' sight accompanied by shippers' invoices, certified consular invoice, and full set of bills of lading covering the invoice cost of cotton No. 2 middling to be shipped from New York, c.i.f. Liverpool.

This credit expires March 1, 1922. Please negotiate for our account all drafts presented to you under this credit, which drafts we hereby agree will meet with due honor upon presentation to us.

We trust you will have notified the beneficiaries of the terms of this credit and thanking you in advance, we remain,

Yours very truly,

JOHN JAMES, for Y Bank of London.

✓ A bank may also ask its correspondent to confirm a credit by debiting the former's balance to the amount of the credit and

setting this sum aside as a special account (see forms 8, 9, 10). If the balance proves insufficient, an overdraft may be allowed, and so the foreign bank is really given a temporary loan until the debit can be overcome. If there is no standing agreement between the two banks or no provision to create a special account, and if a confirmed advice is issued, then the advising bank is assuming an obligation to the beneficiary without receiving security or cover. The issuing of an uncovered advice is the same as the granting of an unsecured loan, and so the advising bank must first determine the standing of the applying bank. This judgment may be based on the latter's own statement of its condition, but this report is of doubtful value in these days of rapidly fluctuating exchange rates. The quotations of a bank's bills in the open market are good expressions of local opinion on the credit standing of the accepting bank. Information may also be obtained by writing to other institutions and requesting their views concerning the bank under consideration. It may at times be regarded as a safe credit risk because of its known affiliations with other banks of international reputation. These are sometimes financially interested in smaller banks and the former act practically as endorsers of the obligations of the latter.

2. *Forwarding of Advice.*—If the request to advise a credit is accepted, it is then communicated to the beneficiary by letter or telegram (see forms 11 and 12). The original letter of advice is sent to the beneficiary and several copies are also made. The notifying bank retains copies for its general files and credit department, and sends another copy to the foreign bank which has requested the advice of the credit. This institution is thus able to see the exact form of the notification given to the beneficiary, and if errors have arisen, they can be quickly rectified by cabling the corrections to the credit-advising bank.

It frequently happens that a bank forwarding the notification of a credit is asked by its correspondent to make alterations in the terms of the credit, such as extending the date of expiration, increasing the amount, changing the terms of the drafts or modifying the clauses of insurance. Upon receiving such instructions, the bank notifies the beneficiary of the amendments and also informs its correspondent abroad whether or not its instructions have been followed. If the original terms of the credit,

or the later alterations, are unsatisfactory to the beneficiary he is usually told to reconcile these matters before he prepares his shipment. The beneficiary may bring the matter to the attention of the domestic advising bank, but it usually is unwilling to undertake these adjustments and prefers to have them settled directly between the beneficiary and his customer. He will then ask the foreign bank which has opened the credit to instruct its correspondent to notify the beneficiary of the final amendments.

3. *Presenting of Documents.*—The exporter may be either a merchant or a manufacturer and so he either assembles the goods or converts them into finished form. When he has filled the order and is ready to make shipment, he then presents the documents evidencing ownership of the goods to the bank in order to obtain payment or acceptance of his draft. He may present his documents directly at the window of the export credit department of the bank, but if there is no need for haste the documents can be sent by mail directly to the bank which is to honor the drafts. The exporting house can also deliver these documents to its own bank which in turn presents them to the drawee bank. For example, the American Cotton Exporting Co. conducts a branch office in New Orleans and gives its documents and drafts to the A Trust Co. of New Orleans which in turn sends them to its New York correspondent, the B Trust Co., which dispatches a messenger with the documents to the X Bank. This institution gives a receipt for the documents, as it will not make payment until it is certain that the documents are drawn in compliance with the terms of the credit. Each document is carefully examined by one or more “checkers” who must be familiar with the principles governing bills of lading and policies of insurance. An error on the part of these checkers may prove costly to the bank, for if it makes payment to the exporter on documents which are not in conformity with the conditions of the credit, the foreign buyer or his bank may reject the shipment and refuse to reimburse the negotiating bank for its outlays. In view of these contingencies, the negotiating bank will reject defective documents and return them with a memorandum describing the irregularities which have caused the rejection. If these irregularities, known as “exceptions,” are unimportant or if the beneficiary is a depositor and of satisfactory credit standing, the bank may accept the documents notwithstanding their defects. In

this event the bank requires the exporter to sign a document known as a "guarantee" which may read as follows:

THE X BANK OF NEW YORK,  
100 Nassau Street,  
New York, N. Y.

DEAR SIRs:

In consideration of your paying to the undersigned, at the request of the undersigned, the sum of £10,000 under your advice of credit No. 1000 opened by Y Bank of London, for account of British Importing Co., such payment being not strictly within the terms of such credit, the undersigned hereby agrees to indemnify you against any loss or damage whatsoever by reason of such payment, and further agrees at any time on demand to repay you at your office, 100 Nassau Street, New York City, the said amount, or such part thereof as you may request, with interest at 6 per cent per annum from the date hereof, together with any expense which you may incur in connection therewith.

Respectfully yours,

JOHN JONES, for American Exporting Co.

Later, if the importer is unwilling to accept the goods because of their discrepancies and refuses to make payment to the negotiating bank, it can then obtain reimbursement from the exporter for the amount of the draft, loss of interest on the bill and any other expenses which may thereby have arisen. But if the foreign buyer agrees to waive the irregularities in the documents and accept them, the foreign correspondent cables or writes its own approval of the payment made by the American bank which in turn releases the exporter from his guarantee. The transaction is then finally closed by canceling the above letter of guarantee which the exporter has signed.

The exporter may be required to tender documents evidencing the location of the merchandise at various stages in its movement to the buyer. The beneficiary is sometimes asked to produce merely railroad bills of lading evidencing the movement of the goods from the interior to the sea board where a forwarding agent makes provision for delivery to the steamship company.

At times the beneficiary must not only care for the shipment of the goods by rail to the port but also for their storage in a warehouse where they remain until transferred to a steamer. Goods must thus be temporarily stored when consigned to ports at which vessels do not make regular calls. Under abnormal

conditions, such as government embargo, freight congestion, labor disturbance or state of war, banks are usually instructed to pay the beneficiaries on their presentation of receipts, attesting to the storage of goods in satisfactory warehouses. While the drafts of the exporter may thus be honored on the delivery either of railroad bills of lading or warehouse receipts, most credits are available only upon presentation of bills of lading indicating that the goods have been delivered to the steamship company or actually placed on board a vessel.

**V. Operation of Credits Which May Be Canceled.**—In this chapter, it has thus far been assumed that the credits could not be canceled. In Chap. III reference was made to credits which could be rescinded, and it was there noted that a bank may issue a letter of credit which is revocable. As a matter of practice such letters are seldom used and some banks refuse absolutely to issue them. When a credit is advised through a second bank, this institution may or may not add its guaranty of payment to the beneficiary and so the letter of advice is confirmed or unconfirmed. As a large proportion of these advices are unconfirmed, they must be given further consideration. In advising a beneficiary of an unconfirmed credit, the notifying bank must word its communication with the utmost care. An examination of the advices of American banks discloses the use of the following expressions:

1. In advising you that this credit has been opened we are acting as the representatives of our foreign correspondents and do not assume any responsibility for its continuance.

2. Please note that this is an unconfirmed credit and is consequently subject to modification or cancellation.

3. As this is an unconfirmed credit, it is subject to cancellation at any time, with or without notice to you.

4. We have no authority from our clients to confirm this credit or to guarantee the acceptance (payment of drafts drawn against it). The credit is therefore subject to cancellation without notice.

5. Kindly note that this is not a confirmed credit, and is consequently revocable at any time, either by the parties granting the credit, or by ourselves under certain conditions.

6. In the absence of any statement to the contrary, the — Bank assumes no obligation whatsoever, even if all the conditions of the credit have been complied with.

In general the advising bank seeks to express the thought that it is acting merely as agent of the bank issuing the credit and that no obligation has been assumed by the adviser (see form 13). The advice also contains the statement that the offer of the advising bank to negotiate the drafts of the beneficiary is subject to cancellation. The question now arises: At what particular point of time may a bank cancel an unconfirmed advice? The views of exporters and bankers were obtained by the author in his study for the Federal Reserve Board and these opinions placed the exact time of cancellation at the following successive stages in the course of a shipment:

- a. completion of manufacture of the goods
- b. delivery of goods to a carrier as evidenced by railroad or ocean bills of lading
- c. presentation of these documents at the office of the notifying bank
- d. negotiation of the beneficiary's drafts by the bank
- e. payment of drafts by credit-issuing bank abroad

a. It is sometimes contended that if a seller has already manufactured specialized goods which cannot well be sold in the market, the credit can no longer be canceled. In answering this argument the banks reply that the seller must run this risk if he accepts a revocable credit.

b. Many exporters feel that delivery of their goods to the carrier, whether railroad or steamship company, and the holding of the documents specified by the letter of advice, should be regarded as the fulfillment of the contract on their part and the termination of the bank's right of cancellation.

c. Many exporters are willing to concede that a bank may cancel its advice at any of the two points mentioned above, but insist that once they present the proper documents over the counter of the advising bank, it can no longer rescind its obligation.

d. Banks, on the other hand, usually maintain that they may cancel an unconfirmed advice at any time before they have negotiated the drafts of the beneficiary. Banks which hold this view insert in the advice to the beneficiary the expression that "the credit may be canceled with or without giving notice." The issue of whether or not a written notice of cancellation must be given will determine the exact time when the order becomes

effective. If notice is required, then a credit may not be canceled when once the beneficiary tenders to the bank documents which are in compliance with the terms of the advice. If, on the other hand, the beneficiary is not entitled to a written notice, the bank may then avail itself of the right of revocation at any time before it has negotiated the drafts of the beneficiary. British courts have decided that a bank is not compelled to give such notice, but American courts have not as yet expressed an opinion on this question.

e. It is held by some banks that cancellation may be exercised by a negotiating bank at any time until final payment is made by the credit-issuing bank. This statement is the equivalent of maintaining that the negotiating bank has a claim or recourse on the beneficiary. Under the Negotiable Instruments Law, a bona-fide holder of a bill, as, for example, a negotiating bank, has recourse on the drawer (the beneficiary) if the drawee (the foreign bank) refuses payment. Many exporters are under the impression that their liability ceases when once a bank has negotiated drafts drawn under irrevocable or revocable letters of credit issued by another bank. This position is at variance with the law of negotiable instruments which recognizes the negotiating bank's right of recourse on the drawer of the draft.

In the above case it has been assumed that the advice to the beneficiary has instructed him to draw his drafts on the foreign issuing bank and has notified him that these bills would be negotiated. This advice may also direct the beneficiary to draw his drafts on the advising bank, but this alteration in no way changes the liability of the drawer. If he draws a sight draft on the advising bank which pays it, then obviously all liability ceases. If, however, the beneficiary, acting under the terms of the credit, draws a time draft, of, say, 90 days, on the American bank which accepts it, the drawer is liable to any holder until the accepting bank has paid the draft. But this liability only arises if the accepting bank becomes insolvent, and so if the bill is drawn on a strong institution, the possibility of the drawer being called upon to make reimbursement is so remote that the question of recourse has no practical interest. A drawer of a draft under a credit may remove even this extreme contingent liability by placing on the draft the expression "Drawn without recourse." ✓ However, banks are unwilling to accept such bills, since they are

ineligible for rediscount at a Federal Reserve Bank and so cannot well be sold in the open market.

**VI. Expiration of a Credit.**—A continual source of controversy between merchants and bankers has been the expiration date of a credit, and so it must be carefully defined in the letter to the beneficiary. Credit letters and advices of American banks contain the following variety of expressions:

1. *Date of Credit.*

- a. "Expiration date."
- b. "Available until."
- c. "This credit becomes void if not used on or before ....."

2. *Date of Draft.*

- a. "Draft under this credit must be drawn prior to ....."
- b. "Draft under this credit must be drawn and negotiated prior to ....."

3. *Date of Bill of Lading.*

"Bill of lading must be dated on or before ....."

4. *Date of Credit and Draft.*

"This credit expires ..... Your draft must be negotiated on or before this date."

5. *Date of Shipment and Draft.*

"Shipment must be completed and draft negotiated on or before ....."

6. *Bill of Lading and Draft.*

"Bill of lading must be dated not later than ..... and draft must be negotiated not later than ....."

The first type which merely states that the credit terminates on a certain day, raises the question of where this expiration actually occurs. Does the credit expire at the office of the negotiating bank or of the credit-issuing bank? For example, the credit of the X Bank issued reads, "Available until April first," can this expression be interpreted to mean that the beneficiary may sell his draft to a negotiating bank until this date, or does it indicate the time limit within which the drafts must be presented to the issuing bank? Some banks give a partial answer to this question by describing their credits as "Expiring in New York" on a certain date before which both drafts and documents must be presented at the office of the credit-issuing

bank. This view is supported by the buyer who thus receives a guarantee that the goods, or at least the shipping documents, will be delivered to him before a specified date. On the other hand, the seller is always desirous of extending the duration of the credit as long as possible and so he would naturally insist that the credit expires at the place of negotiation.

Form 2A which fixes the expiration of the credit at the drawing of the draft by the beneficiary does not fully protect the interests of the issuing bank, since the beneficiary is able to post-date his draft to a time before the actual expiration of the credit. Form 2B overcomes this defect by compelling the beneficiary not alone to draw but also negotiate the draft on or before a certain date. Forms 4, 5, 6, are even more satisfactory from the standpoint of the importer, since they combine the date of the negotiation of the draft with the date of the credit, of the shipment and of the bill of lading, respectively.

Several regulations adopted by the Commercial Credit Conference have particular reference to the subject of the expiration date for payment. When, for example, a credit is said to be available "until April first," or "expires on April first," or when similar expressions are employed, they are regarded as including and not excluding the day mentioned in the credit. Thus the credit given above continues not until March 31 but until April 1 inclusive. When an expiration date happens to fall on a Sunday, or a legal holiday, this date is extended to the next business day. The holiday must of course occur in the locality of the credit-advising bank and not in the country of the foreign correspondent which has opened the credit.

A question arises when a foreign bank cables its American correspondent to extend the date of credit. But suppose the original letter is so worded that the expiration date of the credit is combined with the date of the bill of lading or of the shipment, as: "This credit expires on May 1, on or before which shipment must be completed." Does the extension of the credit also imply that the date of the bill of lading or of the shipment may likewise be postponed? The Commercial Credit Conference has ruled that, in absence of any instructions from the foreign bank, American banks will interpret this extension to apply also to shipment as evidenced in the bill of lading (see Rule B4).

## CHAPTER V

### TRAVELER'S LETTERS OF CREDIT

The letter of credit has thus far been considered solely as an instrument for facilitating the import and export of merchandise. In addition to the commercial letter of credit, there is another instrument known as the traveler's letter of credit which, as the name implies, serves as a means of furnishing the holder with funds at various places on a journey. The commercial and traveler's letters of credit have certain features in common, and are often taken one for the other. In order to draw a clear distinction between these two instruments, this chapter will explain the meaning and classification of the traveler's letter of credit, the parties involved, and the methods of opening and using it. Throughout the study traveler's and commercial letters will be compared for points of similarity and difference.

**I. Meaning.**—Assuming that a tourist is setting forth on a trip to Europe, let us trace the various ways in which he may finance his journey which he estimates will cost him about \$5,000. He may draw this amount from his bank in cash, either in dollars or in the currencies of the countries which he intends to visit, and carry it with him on his trip. In so doing, however, he incurs the risk of losing it or having it stolen. In order to avoid this possibility he may maintain the \$5,000 as a deposit with his New York bank and simply draw checks against the amount. But here again he would probably encounter difficulties in having these checks cashed in a foreign country where he could not well prove either his identity, the genuineness of his signature or the amount of his balance as credited with the bank. These difficulties are overcome by the use of the traveler's letter of credit. In this document a bank formally states that the traveler is authorized to draw on it, or on a foreign correspondent or a branch, sight drafts which one or more of its correspondents or branches will freely purchase with the full assurance that these drafts will be paid when presented at the drawee bank.

**II. Classification.**—The classification of the traveler's letter of credit is less complicated than that of the commercial letter of credit. The former does not involve the shipment of merchandise, and so payment of the drafts is not conditioned upon the presentation of any bills of lading or commercial invoices. Consequently the traveler's letter of credit is never documentary but always clean in the sense that it authorizes the drawing of drafts unconditionally. These, moreover, are never time but always sight drafts, and so a traveler's letter represents not an acceptance but a cash credit. A traveler's letter of credit cannot be transferred, for it can be availed of only by the beneficiary himself. No advantage would be derived from a transferable traveler's letter of credit for, under the ordinary form, the holder is able freely to deliver any part of the credit to another person by merely drawing a draft for this amount and, upon receiving the cash, simply giving it to the other party.

Traveler's letters of credit cannot well be grouped on the basis of conditions as to cancellation, for the party opening the credit is at the same time the beneficiary or closely associated with him. A traveler's letter of credit can be canceled by no one but the beneficiary himself, and he would take this action only if he no longer desired to avail himself of the credit, or if he desired to prevent its misuse by someone who may have wrongfully come into possession of it. There is little need of classifying traveler's letters of credit according to place, for they are used mainly by persons traveling in foreign countries. For a trip within the United States the ordinary check, or the traveler's check, is sufficient to meet all necessary disbursements. In short, traveler's letters evidence clean, cash, non-transferable, foreign credits.

Traveler's letters of credit may well be grouped according to the currency in which the drafts are drawn. The New York bank may issue the letter in dollars and so the drafts are drawn on the bank itself. In the case of a sterling credit, the drafts are drawn on a correspondent bank or branch office located in London. In like manner, credits may authorize payment in francs or marks.

The method of negotiation also determines the classification of the traveler's letter of credit. The issuing bank may address the letter of credit to but one bank, which alone has the right

to negotiate the drafts of the beneficiary. This type is known as the "specially advised" letter of credit. Most letters of credit are "circular" in the sense that they are addressed in general to correspondent banks all of whom may cash the drafts of the beneficiary.

**III. Parties.**—A firm may open a traveler's letter of credit in favor of a salesman or representative who is going abroad. More usually the prospective traveler opens the credit for himself, and so the opener is at the same time the beneficiary of the credit. The other parties to a traveler's letter of credit are in about the same relation to one another as in the case of a commercial letter of credit. In the first place the bank issuing the letter of credit usually authorizes the beneficiary to draw the drafts on the bank itself, as in the case of a New York institution issuing a credit in dollars. If the letter of credit calls for payment in pounds sterling or in some other foreign currency, the drafts are then drawn on an institution other than the issuing bank. An exception arises where a bank is able to authorize drawings on one of its own branches located in London, Paris or Berlin. The traveler's letter of credit necessarily involves a negotiator who purchases the drafts of the beneficiary. The parties to a traveler's letter of credit therefore are (a) opener and beneficiary, (b) issuer, (c) drawee, and (d) negotiator.

**IV. Direct Opening of Credit.**—A tourist desiring a traveler's letter of credit applies to a bank in much the same manner as in requesting a commercial letter. The applicant fills out a blank form which calls for such information as name of beneficiary, amount of credit, date of expiration, and terms of payment. In the case of a "cash" credit, the applicant pays in money or by check for the total amount of the credit if in dollars; or, if in foreign currency, for the equivalent in dollars at the current selling rate of exchange for bankers' checks on London, Paris or Berlin. The entire transaction can be compared to the depositing of cash by the customer who in return receives credit for the amount on the books of the bank. Against this deposit credit the customer has the right to draw drafts. Deposit credit in domestic bank operation can be created not only by the customer leaving cash with the bank, but also by the bank extending credit in making a loan to the customer. Likewise, a traveler's letter of credit may

be the result of a procedure which is quite similar to a loan by the bank, as in the case of a "guaranteed" letter. In this type, the issuing bank does not receive payment from the opener for the full amount of the credit but obtains reimbursement only as it pays the drafts drawn by the traveler and presented by the negotiating bank. As a loan may be either secured or unsecured, so a guaranteed credit may be based in the one case on collateral and in the other on a mere promise of the applicant to place the bank in funds when the occasion for doing so arises. While in the case of a cash credit a simple application is sufficient; for a "guaranteed" credit it is necessary for the applicant to sign an agreement. By the terms of this contract, the applicant agrees to repay the bank for all its disbursements under the letter of credit, and to assure the performance of his obligation he pledges certain approved security, such as marketable stocks and bonds. He agrees to maintain these securities at a sufficient margin above the amount of the credit and, in the case of depreciation, to furnish additional collateral.

✓ A "guaranteed" traveler's credit, as mentioned above, may also be unsecured, as when it is based merely on the written pledge of the beneficiary that he will reimburse the bank for all its outlays. A request for this type of a traveler's credit is considered in the same manner as an application for an unsecured loan, and it is necessary for the credit department first to determine the applicant's standing. If it is satisfactory, he is given the credit on signing an agreement or guaranty.

✓ **V. Indirect Opening of Credit.**—Thousands of small banks throughout the United States have so little foreign business within the year that it is not worth their while to maintain correspondent relations abroad. These banks are therefore unable to issue traveler's letters of credit directly, but they perform this operation indirectly through a city correspondent with established connections in foreign countries. The city correspondent supplies the interior bank with a batch of letters all ready for use on the strength of a trust receipt signed by the latter institution. In this agreement the interior bank acknowledges the receipt of the letters and promises to assume full responsibility for these instruments. The city bank usually protects itself against over-issue by writing upon each letter of credit the

statement that the amount must not exceed a certain maximum limit, say about \$2,500. Whenever the interior bank issues a letter of credit on the request of a local customer, it immediately advises the city correspondent and forwards specimen signatures of the prospective traveler.

**VI. Form of Letter.**—Traveler's letters are issued by banks in forms which are somewhat varied, but they do not present the same lack of uniformity to be found in commercial letters of credit. As indicated above, the traveler's letter contains a request that the drafts of the beneficiary be cashed and an undertaking that these bills will be honored by the issuing bank. The letter is sometimes printed as a large folder which contains a list of the bank's correspondents who will cash the drafts of the beneficiary. At times a specimen of his signature also appears in the lower left-hand corner of the letter as a means of enabling the negotiating bank to identify the handwriting of the true beneficiary of the drafts. This type is quite convenient, furnishing a complete document, including the letter of credit, the list of correspondents and the signature of the beneficiary. On the other hand, this form is quite open to misuse, for if it falls into the hands of the wrong party, he may imitate the signature found on the letter, and present it together with forged drafts to one of the correspondents whose names appear on the attached list. In order to reduce the possibilities of fraud, banks generally issue a separate card of identification, or "letter of indication" as it is called, containing the signature of the beneficiary and the list of correspondent banks. This document may be in the form of a large folder or a small booklet. The beneficiary is asked immediately to sign his name, and is advised to carry the letter of indication separate from the letter of credit proper. Since one instrument is the complement of the other and since both are necessary to enable the holder to negotiate drafts, the possession of either one alone by the wrong party would not allow the fraudulent cashing of drafts. The reverse side of the letter provides space in which the negotiating bank enters such details as date when the drafts are paid, by whom they are paid, and the amount in words and in figures. These entries are essential in order to prevent the beneficiary from drawing drafts in excess of the total amount of the credit.

**VII. Operation of a Traveler's Credit.**—The traveler arrives

in Paris where he finds himself in need of funds. He refers to the list of foreign correspondents and selects one located in Paris. He goes to this banker, exhibits his letter of credit and requests the payment of say \$200. The banker then fills out a draft for this amount on the American bank which has opened the credit, and has the beneficiary sign it. His signature is compared with the letter of indication, and if satisfied as to the authenticity of the writing, the foreign banker buys the draft. The banker thus receives dollar exchange and gives the beneficiary the equivalent in francs. This conversion is made by the banker on the basis of his buying rate on that day for dollar sight drafts on New York. The negotiating banker endorses the necessary details on the reverse side of the letter and returns it to the traveler. The draft is then sent to a New York correspondent which in turn presents it to the drawee bank for payment. Frequently the negotiating bank sends the draft directly to the issuer of the letter, especially when the two institutions stand in relation of branch to home office.

A somewhat different procedure is followed in the operation of a sterling credit. In issuing this form of credit, the American bank specifies in the traveler's letter of credit the name of its London correspondent on whom drafts are to be drawn. The American bank, on issuing a sterling credit, sends its British correspondent specimens of the beneficiary's signature. The negotiator of the draft remits them to the London bank which compares the signature on the draft with that on the specimen card. If the writing appears genuine, the London bank pays the draft and charges the amount against the account of the American bank which has issued the letter of credit.

The letter thus enables the traveler to obtain funds from any of the numerous correspondents of the issuing bank. Also the letter serves as a means of introduction and in a way is the issuing bank's expression of the credit standing of the holder. For performing these services the various banks involved in the transaction naturally receive a compensation in one form or another. The interior bank, which has no foreign connection of its own but is selling the letter merely as an agent, receives a commission of usually  $\frac{1}{4}$  of one per cent of the amount of the credit. The bank which issues the credit also receives a similar commission but at times may exact no charge at all. This insti-

tution is able to charge little or even nothing for the letter, since it has use of the funds until the credit is exhausted by the beneficiary. Besides, the bank derives a publicity advantage in having its letters of credit carried all over the world. The foreign correspondent, in negotiating the drafts, buys them at its own quotation on sight bills and thus obtains a profit on the purchase of exchange on New York or London.

## CHAPTER VI

### THE LETTER OF CREDIT IN AMERICAN LAW —PRINCIPLES

I. Definitions and Classifications of the Letter of Credit in American Law.—Before analyzing the American cases dealing with the letter of credit, it may be well first to consider some of the definitions of this instrument as found in the laws of the states, decisions of the courts and commentaries of jurists. The codes of the states of California, Montana and the Dakotas all describe a letter of credit as a “written instrument addressed by one person to another requiring the latter to give credit to the person in whose favor it is drawn.” The same thought is expressed in the recent case of *American Steel Co. vs Irving National Bank* (266 Federal Reporter 41), which regards a letter of credit as a “letter requesting one person to make advances to a third person on the credit of the writer.” Judge Joseph Story in his work on “Bills of Exchange,” p. 459, defines a letter of credit as a “letter of request, whereby one person (usually a merchant or banker) requests some other person or persons to advance moneys, or give credit to a third person, named therein, for a certain amount, and promises that he will repay the same to the person advancing the same or accept bills drawn upon himself for the like amount.”

Considering next the classification of letters of credit as presented in the above sources, we find that the court, in *American Steel Co. vs Irving National Bank*, groups these instruments as either general or special. “They are general,” says the court, “if directed to the writer’s correspondents generally; they are special if they are addressed to some particular person.” In a similar tone, Judge Story observes that the instrument in question is called “a general letter of credit when it is addressed to all merchants, or other persons in general, requesting such advance to a third person; and is called a special letter of credit when it is addressed to a particular person by name, requesting him to make such advance to a third person.” The definition and

classification of the letter of credit presented above has been accepted in American law from the early decisions of John Marshall to current articles in legal reviews.

An examination of these statements indicates, however, that they apply not to the commercial but rather to the traveler's letter of credit described in the previous chapter. It was there noted that the traveler's letter of credit was a communication sent by a banker to one or more of his correspondents who are requested to give credit to a beneficiary by cashing his drafts. On the other hand, the commercial letter of credit is rather an authorization to a beneficiary to draw his drafts. The distinction between these two instruments is well drawn in a British case (*Union Bank of Canada vs Cole*, 41 Law Journal, Queen's Bench, 100) which regards commercial letters of credit as "giving credit but not requesting any third party to give credit." In addition to this essential difference in the nature of the two documents, other dissimilarities were noted in the preceding chapter. These distinctions have not been generally appreciated by judges in their decisions or by writers in their comments and as a result considerable confusion today surrounds the legal aspects of letters of credit.

**II. Historical and Legal Evolution of the Letter of Credit.**—The cause of this confusion in American law can be found in the historical evolution of the letter of credit. It came into extensive use by American exporters about the opening of the nineteenth century when the Napoleonic Wars drew thousands of men from the farms of Europe and caused a well-nigh insatiable demand for wheat and other foodstuffs produced in the United States. Along with this, the Industrial Revolution in England expanded the manufacture of textiles and created an almost unlimited market for American cotton while its production at the same time was stimulated by the invention of Whitney's gin. Although these exports were often financed by the letter of credit, it was in a form akin to the present day traveler's rather than to the commercial letter. The instrument thus evolved, in time became the subject of litigation and was the basis of numerous decisions by Chief Justices Marshall and Story. After the first quarter of the nineteenth century, fewer cases on letters of credit arose, due partly to the fact that foreign commerce declined relatively in proportion to domestic

trade which increased rapidly with the development of the West.

During the first half of the nineteenth century, Great Britain also underwent rapid economic changes. As a result of the Napoleonic Wars, the center of finance shifted definitely from Amsterdam to London. The increase in the production of manufactured goods compelled England to seek markets abroad and an ever-expanding foreign trade was developed by British merchants. Some of them applied their capital to founding institutions to finance overseas trade, and in doing so developed the letter of credit from its old form which resembled the traveler's letter into the modern or commercial type. This evolution is clearly evidenced in the cases which are reported from time to time in the records of the British courts. About the middle of the nineteenth century with the growing use of the sterling bill as the currency of international finance, cases on letters of credit became more frequent and by the close of the century the nature of the instrument and the liabilities of parties to it were well defined in the British law.

In the United States the letter of credit declined relatively in use due largely to the fact that after the Civil War the bill of exchange yielded to the promissory note as a means of settling business transactions. In the meantime, the new or commercial form of letter of credit, as developed in England and on the Continent, was gradually introduced in the United States and a few cases involving this instrument came before the American courts. Most of these credits were drawn in sterling and did not present some of the innovations which have arisen since 1914 when dollar credits were first issued on an extensive scale. Although the letter of credit was used to finance exports worth hundreds of millions of dollars from 1914 until 1919, only a negligible amount of litigation arose either in American or British courts. The absence of legal controversy may be explained by reference to the abnormal war demand which absorbed goods regardless of prices. The rejection of a shipment or the cancellation of an order rarely occurred.

The change in the price level after May, 1920, was followed by serious consequences all over the world. The collapse of the Japanese silk market, the debacle in the Javanese and Cuban sugar industry, the fall of quotations on South American coffee,

all were phases in the most precipitous world-wide decline in prices recorded in the history of economics. This change was followed by economic results which are still unmeasured. In commerce it led to widespread cancellation of orders and general repudiation of contracts. The letter of credit, as an instrument defining the relation of parties in many of these transactions, became the subject of acrimonious litigation. American judges, confronted with the complications arising from the use of the modern commercial letter of credit, naturally turned to precedent in an effort to unravel the confused issues presented by the litigants. But the early cases on letters of credit, as shown above, dealt with a form which today is used not in commerce but in travel. In some instances, the early principles were applied to the cases before the court with the result that the argument of the attorneys and the reasoning of the judges often had little relation to modern commercial usage. Fortunately, many of these principles apply to both the traveler's and the commercial credit, and so the decisions for the greater part happened to arrive at equitable conclusions, but only after wandering through a maze of legal reasoning rendered inconsistent by the attempt to reconcile the older letter of request (traveler's) with the modern letter of authorization (commercial). This chapter will present the several theories which have been suggested as a legal basis for the commercial letter of credit. The next chapter will analyze cases which have been presented before American courts, but consideration will be confined only to those decisions which deal directly with the commercial or authorization form of letter of credit.

**III. Legal Theories on the Letter of Credit.**—Within the last few years, the various legal theories concerning commercial letters of credit as found in American cases have been analyzed in several excellent contributions to legal literature.<sup>1</sup> According to these commentaries, the effect of the letter of credit in law may be based on the following possible theories:

<sup>1</sup> See *Harvard Law Review*, November, 1918, vol. 32, No. 1, pp. 1-39, March, 1921, vol. 34, No. 5, pp. 533-536, April, 1922, vol. 35, No. 5, pp. 539-592, May, 1922, vol. 35, No. 6, pp. 715-742; *Columbia Law Review*, February, 1921, vol. 21, No. 2, pp. 176-178, April, 1922, vol. 22, No. 4, pp. 297-333.

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|--------------------------|------------------------------|
| 1. Equitable assignment. | 4. Unilateral contract.      |
| 2. Estoppel.             | 5. Bi-lateral contract.      |
| 3. Guaranty.             | 6. Notification of contract. |

1. The supporters of the theory of equitable assignment of funds view the letter of credit as a document in which the issuing bank acknowledges the possession "of money had and reserved and held for the use of the addressee [beneficiary]." According to this theory it would appear that a commercial credit transaction arises by an importer depositing a sum of money with a bank which then issues a credit letter informing the beneficiary that in his behalf a trust fund is being held by the bank. This theory naturally finds support among exporters and, strangely, even among a number of bankers (see article by author in *Federal Reserve Bulletin*, February, 1921, p. 169). It must be evident to the reader that this description of the operation of a commercial credit is at variance with the presentation as given in Chap. III. It was there noted that an importer rarely deposits cash with the bank issuing the letter, but instead the entire transaction is generally based on credit. The letter to the beneficiary is not an acknowledgment of a trust fund of cash but rather a statement of an amount of credit extended to the opener who has requested the issuance of the letter.

As explained above the letter of credit is similar in some ways to a bank passbook since both evidence merely a certain amount of credit entered in the books of the bank. If the theory of equitable assignment were to be accepted in reference to commercial credits, it would have to apply with equal force to ordinary deposits. These would then be regarded as constituting actual cash, but as a matter of fact, the greater portion of bank deposits are the result of extensions of credit by the bank to its customers. The doctrine of equitable assignment is clearly rejected in the British case of *Morgan vs Larivière* (1875) Law Reports, Vol. 7, House of Lords, 423 (see p. 155 below).

2. The theory of money received and held for the use of the beneficiary is sometimes combined with that of estoppel. It is held that by the letter of credit the issuing bank makes a representation which it is estopped to deny after the beneficiary has once taken action such as shipping the merchandise. This theory finds best expression in the case of *Johannessen vs Munroe* (158 New York 641) which reads in part as follows:

"We are of the opinion that this entire transaction, beginning with the issuing of the letter of credit and closing with the settlement referred to, presents all the elements of an estoppel, and defendants are precluded from setting up a defense based upon the alleged invalidity of the letter of credit for any cause—we have here the representation of certain facts by the defendants [issuing bankers], with knowledge that the plaintiff [beneficiary] proposed to act thereon; the fact that he did so act and took the letter of credit and money in payment of his claim, releasing all parties from further liability. This constituted a taking of the letter of credit in good faith and for value. The plaintiffs by the representations of defendants were induced to change their position."

3. In a number of cases the letter of credit is regarded as a guaranty addressed by the issuing bank to one or more persons that they will be reimbursed by the bank if they will extend credit to the beneficiary. It is evident that these cases apply to the traveler's or request form of letter of credit which, as indicated above, is addressed to the correspondents of the issuing bank. While the guaranty theory cannot well be applied to the commercial letter of credit, it does explain the nature of the application for a letter of credit. In this instrument the importer requests the bank to issue its letter of credit and gives assurance of reimbursement for all payments made by it. The opener thus gives his guaranty to the issuer of the letter of credit. The guaranty theory may also be extended to the communication sent by a credit-issuing bank to its correspondent which is asked to confirm the credit.

4. A commercial letter of credit may also be conceived as a unilateral contract arising from an offer by the issuing bank of certain terms and their acceptance by the beneficiary through his compliance with them. This conception approaches very closely to the actual operation of a commercial credit. In a way the bank may be regarded as the consignee of the goods, since bills of lading are usually filled out in its name. The revocable letter of credit may correctly be regarded as an offer which can be rescinded by the offerer any time before acceptance by the offeree who has not involved himself in any way. But this contract theory cannot well be extended to the irrevocable letter of credit in which the issuing bank assumes an engagement which

cannot be recalled within a specified period of time without the consent of the beneficiary.

5. The letter of credit, especially if irrevocable, may be viewed rather as a bilateral contract. The opener agrees to give a consideration to the bank for its promise to honor the drafts of the beneficiary. The consideration may possibly take the form of a deposit of actual funds but more likely it will be merely the assurance that it will reimburse the bank for all its advances. These conditions are, of course, fixed not in the letter of credit but in the agreement between the opener and the bank. The theory which regards the irrevocable letter of credit as a bilateral contract between the issuer and beneficiary has been accepted in several recent decisions (*American Steel Co. vs Irving National Bank*, 266 Fed. 41; *Frey & Son vs Sherburne and Co.*, 184 New York, Supp. 661; *Sovereign Bank of Canada vs Bellhouse, Dillon & Co.*, 23 Kings Bench 413. In *Peter Doelger vs Battery Park National Bank*, the court expressed the following opinion:

"In the law of bills and notes, if a third person gives consideration to the maker of a promissory note in exchange for his promise to pay the payee, the latter can sue upon it, regardless of the fact that he furnished no consideration (*Pierce vs Harper*, 249 Fed., 876; *Crosier vs Crosier*, 215 Mass., 535; *Farley vs Cleveland*, 4 Cowen, 432; *Williston Contracts*, Sections 114, 354). In New York and elsewhere this rule applies to simple contracts (*Hamilton vs Hamilton*, 127 App. Div., 871; *Rector, etc., vs Teed*, 120 N. Y., 583; *Palmer Savings Bank vs Insurance Co. of N. A.*, 166 Mass., 189). This doctrine seems to accord with the circumstances of the present letter of credit. It is clear, also, that by the application of the principle referred to, which is based upon the theory of a bilateral contract ab initio, full effect can be given to the term 'irrevocable' as used in the letter, which would not be the case if the letter is to be governed by the law of offer and acceptance or of estoppel. The buyer of the goods furnished the consideration to the bank in exchange for the bank's promise to Doelger to honor his drafts on condition that Doelger shipped steel to the buyer in pursuance of the terms of the letter of credit. But if during the life of the credit and before Doelger had shipped any goods, or even before he had bought goods to ship, the bank revoked its credit and announced that it would refuse to honor any drafts that might be presented, it would seem reasonable to hold the bank liable for the profit Doelger

might have made if he had not been prevented from carrying out his part of the transaction."

6. It is sometimes held that the letter of credit is not a contract in itself but merely a notification of a contract. In view of the opinions expressed in the cases cited above, this explanation is rather insufficient. The theory of notification, however, fits exactly the advice of a bank confirming a credit. It will be recalled that this advice may read: "At the request of the X Bank we hereby confirm their credit opened in your favor." This credit is opened by a foreign correspondent acting at the request of its customer, and the contract is the communication sent by the bank originally opening the credit to the bank confirming it.

## CHAPTER VII

### THE LETTER OF CREDIT IN AMERICAN LAW —DECISIONS

The letter of credit has been the subject of many decisions by American courts, but only a few apply to the commercial letter of credit. Some of these cases are rather unsatisfactory since the judges have at times failed to understand the true nature of the letter of credit and consequently made statements which depart from the actual facts of the cases involved. However, the group of decisions taken as a whole may be regarded as having established a firm and, on the whole, satisfactory legal foundation for American credits and dollar exchange.

Litigation over letters of credit naturally arises from the refusal of a party to fulfill his engagement, as when the issuer cancels the credit, or the opener refuses reimbursement to the negotiator. Cases involving these issues will be considered by presenting the principle involved, the facts of the case, the decision of the court and general comments. A diagram will be used to show the relation of the parties to one another and the sequence of their successive acts and, wherever court records permit, the documents such as letters of credit, applications and contracts will be reproduced in full.

#### I. A Bank May Not Cancel Its Clean Irrevocable Letter of Credit Before Its Expiration Date.

*Johanessen vs Munroe*, 158 New York 641.

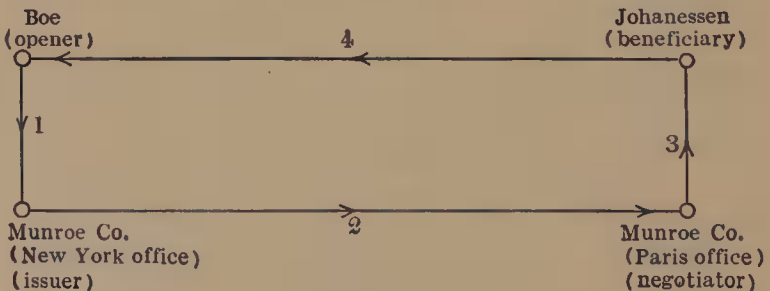


FIG. 1

1. A ship broker engaged in business in New York City paid a sum of money to Munroe & Co., bankers, to open a letter of credit with their Paris office in favor of Johanessen, captain of a Norwegian steamship.

2. Accordingly Munroe & Co. sent to their Paris office the following communication:

"Office of John Munroe & Co., Bankers,  
New York, Feb. 26, 1892.

MESSRS. MUNROE & Co.,  
Paris.

GENTLEMEN:

We hereby open a credit with you in favor of Captain J. A. Johanessen, *S.S. Raylton Dixon*, for frs. 15,000, available in bills at 90 days' date; on acceptance of any bill or bills drawn under this credit you are to draw on Carsten Boe, New York, at 75 days' date; payable at the current rate of exchange for first-class bankers' bills on Paris on day of maturity. Commission is arranged. Bills under this credit to be drawn at any time prior to May 1, 1892.

JOHN MUNROE & Co."

The bill may be availed of in sterling, if desired; say £600 sterling.

3. The Paris office in turn informed Johanessen of the opening of the credit.

4. The business transaction between Boe and Johanessen was not completed, and the latter incurred a financial loss of \$3,700 which the former offered to settle by giving \$500 in cash and £600 in the form of the above letter of credit. Johanessen gave Boe a receipt for this amount in full settlement of all claims, but Munroe & Co. informed Johanessen that they were about to instruct their Paris office to cancel the letter of credit. Counsel for Johanessen replied that the drafts would be drawn on the Paris office and if the credit were dishonored, the issuing bank would be held responsible.

*Decision.*

"The entire transaction presented all the elements of an estoppel which precluded the defendants from setting up a defense based upon the alleged invalidity of the letter of credit for any cause."

*Comment.*—The case does not involve the usual letter of credit addressed by the issuing bank to the beneficiary, but is based

on a communication between the issuing bank and the notifier which, in this instance, is a branch office. The document is a clean letter of credit, since payment is not conditioned upon the presentation of any documents by the beneficiary. Furthermore, the credit is irrevocable, since drafts are available until May first, and no mention is made of the right of cancellation by the issuing bank. As the letter of credit was clean and irrevocable, the bank was unconditionally obligated to honor the drafts if drawn by Johanessen before the date of expiration. The court in deciding for the beneficiary was upholding the inviolability of an irrevocable letter of credit as the unqualified promise of the issuer to honor the drafts of the beneficiary. The court in its decision expressed the fundamental function of banking, the substitution of better known for less known credit as follows: "The plaintiff would naturally have greater confidence in the credit of a well-known banking house than in the financial ability of Boe who had just defaulted in his charter contract."

## II. An Irrevocable Letter of Credit May Be Canceled After Its Expiration Date.

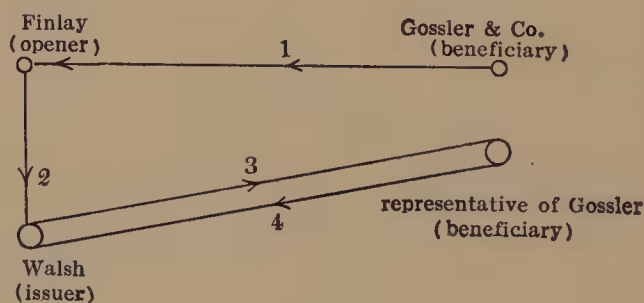


FIG. 2

1. Gossler & Co. entered into a contract to sell to a party named Finlay a quantity of sugar from St. Vincent, to be a "May-June shipment," and to be financed by a letter of credit expiring on June 30.

2. Finlay applied for a letter of credit, coinciding exactly with the contract of sale, to Walsh, a New York banker.

3. Welsh telegraphed to Gossler's representatives in St. Vincent a credit as dictated by Gossler. This credit failed to contain the prohibition against its use after June 30.

4. The representatives of Gossler did not ship the sugar until

in July and then drew drafts under the credit. Finlay refused to accept the sugar because it had not been shipped before June 30 in compliance with the contract. As the bills of lading had been made out to Welsh, the banker, he had legal possession of the sugar. Welsh agreed to surrender the sugar to Gossler provided the latter would pay the advances made in paying the drafts drawn by the exporters in St. Vincent. Gossler refused and Welsh sold the sugar. The proceeds of this sale did not cover the full amount of the money paid out on the drafts, so Welsh sued Gossler for the balance.

*Decision.*

"Finlay might accept the sugars notwithstanding the delay. He might waive the provision of the contract which required June shipment. If he did, the appointees [representatives in St. Vincent] were rightfully in possession of the money as paid upon the latter's contract of sale. But if he did not, if he refused to accept, and stood upon the terms of the contract, then Gossler & Company were in the position of appropriating plaintiff's money as a loan or advance upon the faith of the sugar shipped to the plaintiffs to sell on commission. . . . Finlay was not bound to accept sugar shipped in July; neither defendants nor their representatives in St. Vincent acquired a right to use the credit after June 30, although the form of the telegraphed credit enabled them to do so."

*Comment.*—*Johanessen vs Munroe* and also the above case are both concerned with the expiration date of a letter of credit. In the former case, the court held that an irrevocable letter of credit could not be rescinded before the expiration date. In *Welsh vs Gossler*, the beneficiary, through his representatives, availed himself of the credit after June 30, the day when the credit was to terminate. Had Gossler observed all the terms of the credit by making shipment during June and drawing drafts before June 30, Finlay, the purchaser, would have had no other choice but to make payment. As Gossler failed to observe the condition as to time, Finlay was in a position to accept or reject the shipment. He chose the latter course and in so doing was fully within his rights. The case of *Welsh vs Gossler* was cited in *Higgins vs Steinhardt* (106 Miscellaneous New York 168), in which the court granted an injunction restraining the payment of drafts drawn under a letter of credit after its expiration date.

### III. A Letter of Credit May Be Cancelled by the Issuer Upon Notice to the Beneficiary, But Not After He Has Drawn His Drafts.

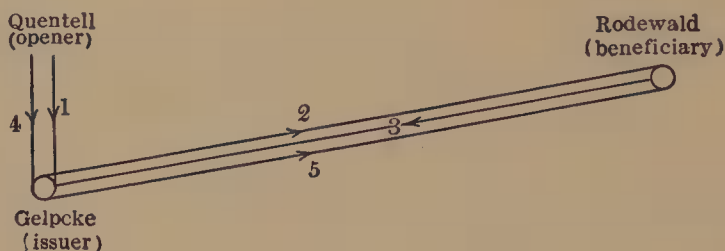


FIG. 3

1. Quentell, a merchant and banker of Bremen, was importing merchandise from the firm of Rodewald & Co., of New Orleans, and in their favor opened a letter of credit with Gelpcke, a banker of New York. The communication sent by Quentell to Gelpcke read as follows:

“Bremen, Dec. 24, 1859.

“I take the liberty to open a credit with your house for my account in favor of Messrs. Henry Rodewald & Co. in New Orleans for the amount of \$50,000 to be used by 60 days’ sight drafts. This credit is intended for advances on consignments of merchandise to my address, and you will please to keep the same in force for the coming year, 1860. It is, however, not required that bills of lading accompany the advice of the drafts. Requesting you, by a few lines, to advise Messrs. Rodewald & Co. of the opening of the credit, and assuring you that your draft for reimbursement to a point to be drawn on me at maturity of your acceptances will be promptly honored.”

2. On January 17 Gelpcke thereupon sent Rodewald & Co. the following communication:

“We hereby have the pleasure to inform you that our mutual friend, Wm. Ed. Quentell of Bremen, has opened a credit with us, in your favor, for the sum of \$50,000—say fifty thousand dollars—to be used by your drafts 60 days’ sight against shipments of consignment to the address of said friend. In confirming this credit, we hope you may soon have occasion to make use of it. Your drafts will meet with prompt protection.”

3. On February 1, 4 and 7 Rodewald & Co. drew their drafts

on Gelpcke who accepted them on February 8, 10 and 13 respectively.

4. On February 6 Gelpcke received from Quentell the following letter of revocation:

“Referring to my letter of 24 ult. by which I took the liberty of opening a credit with your esteemed house, in favor of Messrs. Henry Rodewald & Co., New Orleans, for \$50,000, I find myself today induced to recall hereby this credit, since our New Orleans friends would hardly have occasion to still make use of the same. If, however, in the meantime, up to the arrival of this letter, acceptances should have been made against it, this, as a matter of course, is for my account, and your drafts for reimbursement will be promptly honored on my part.”

5. On the same day Gelpcke wrote Rodewald as follows:

“Referring to our respects of the seventeenth, we have to inform you that according to instructions received this morning from Wm. Ed. Quentell, in Bremen, the credit opened by him in your favor for \$50,000 has been recalled, and is therefore canceled.”

Gelpcke, who had already accepted several drafts, paid them at maturity, but Quentell refused to reimburse Gelpcke for these advances. Gelpcke thereupon sued Quentell for the advances made under the authority of the letter of credit.

*Decision.*

“The defendant [Quentell] could not, by his revocation of the credit, escape liability to indemnify plaintiffs [Gelpcke] against responsibilities which they had incurred, or require them to violate contracts which they had made, in pursuance of the letter of credit before notice of the revocation; that as, in pursuance of the defendant’s instructions, plaintiffs had given credit to Rodewald & Co., and promised to accept their drafts, which credit was outstanding at the time they received the revocation; it was binding upon them, and they were bound to accept the *drafts drawn by Rodewald & Co. before they were notified of the withdrawal of the credit* thus given them. . . . In fine that by the terms of plaintiffs’ agreement which they made on the faith of defendant’s implied promise to indemnify, they were bound to accept the drafts, and they were not required to decline to accept after receipt of notice of revocation and take the chances of a defense existing, of which they know

nothing, but were entitled to perform their contract, and look to defendant for indemnity, especially as the reason assigned by defendant for revoking the credit negated the idea of any apprehension of irregularity or unsoundness on the part of Rodewald & Co."

*Comment.*—Quentell, a merchant-banker, was financing his own imports and opened a credit through a New York correspondent. From the text it is not quite clear whether the letter of credit was irrevocable or revocable. The contention that the credit was irrevocable may be based on the expression reading, "You [Gelpcke] will please keep the same in force for the coming year, 1860." Besides, there is no statement covering the right of the issuer to cancel the credit. On the other hand, the letter of credit does not contain a definite expiration date which usually accompanies an irrevocable credit, and as a matter of fact, the right of revocation was apparently recognized by all parties to the action.

The letter of credit was not addressed to the beneficiary directly but forwarded to a New York banker (Gelpcke) who in turn notified the beneficiary (Rodewald). The communication sent by Gelpcke to Rodewald may be regarded as an advice of a credit opened by Quentell. Although the letter from Gelpcke to Rodewald happens to employ the expression "confirming the credit," the communication is not a confirmed but really an unconfirmed advice.

It would appear from this decision that a beneficiary may continue to draw drafts until he receives notice of cancellation and that the bank is obligated to honor these drafts. This legal interpretation of the exact time when cancellation takes effect is somewhat too liberal, for a beneficiary would be able to ante-date his drafts and thus fraudulently avail himself of the credit. For example, a beneficiary, say on March 15, receives notice of the cancellation of a credit and writes his bills immediately but dates them March 13. Under the above decision the drawee bank would have to honor the drafts. As a matter of practice it is generally held that the beneficiary at best can demand payment only if he presents the drafts to the bank before he has received notice of cancellation (see *Panoutsos vs Raymond Hadley Corp.*, p. 139; *Cape Asbestos Co. vs Lloyds Bank*, p. 141).

**IV. A Bank Cannot Revoke Its Letter of Credit Because the Drafts Presented by the Beneficiary Have Been Drawn in Violation of ■ Sales Contract.**

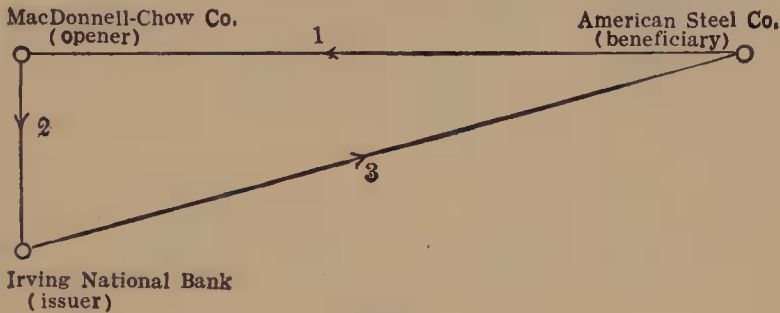


FIG. 4

*American Steel Co. vs Irving National Bank*, 266 Federal Reporter 41.

1. The American Steel Co. and the MacDonnell-Chow Co. entered into a sales contract whereby the former was to furnish an amount of tin plates f.o.b. Pittsburgh district.

2. The MacDonnell-Chow Co. requested the Irving National Bank to issue its irrevocable letter of credit.

3. The Irving National Bank gave the American Steel Co. the following letter of credit:

"AMERICAN STEEL CO.

GENTLEMEN:

You are hereby authorized to draw upon us for account of MacDonnell-Chow Corp. at sight to the extent of Forty-three Thousand Two Hundred Fifty (\$43,250) covering shipment of tin plates.

Documents (complete sets unless otherwise stated), comprising bills of lading issued to order, indorsed in blank.

Invoices.

Insurance policies covering marine and war risk to be delivered to us against payment.

Insurance as above.

Bills of lading issued by forwarding agents will not be accepted, unless specifically authorized herein, and any modifications of the terms of the credit must be in writing, over authorized signatures of this bank.

Drawings must clearly specify the number of this credit.

Yours very truly,

IRVING NATIONAL BANK OF NEW YORK."

The American Steel Co. delivered the tin plates to the Waynesburgh Washington R. R. Co., which is in the Pittsburgh district. The railroad bills of lading dated April 23, 1918, invoices and drafts were presented to the drawee bank which refused payment. The bank based its action mainly on the ground that shipment had not been made within the time limit specified in the contract of sale.

*Decision.*

"There is but one vital question involved in this case. It is whether the letter of credit already set forth herein is a complete and independent contract between the plaintiff and the defendant. This court is satisfied that it is, and that by it the defendant gave authority to the plaintiff to draw upon it to the sum of \$43,250 and impliedly promised to pay drafts so drawn, when accompanied by certain specific documents, to wit, the invoices and bills of lading, provided the drafts were drawn and presented prior to the expiration of the credit on June 13, 1918.

The defendant in effect seeks to read into the contract a provision that the plaintiff's rights under the letter of credit should be subject to the superior right of the MacDonnell-Chow Corp. to modify the contract which the bank had made with the plaintiff. We do not so understand the law."

*Comment.*—The court record of the above case is quite incomplete and at times ambiguous. For example, it is stated that the letter of credit was "issued by the defendant [Irving National Bank] to the plaintiff [American Steel Co.] for a valuable consideration received by the defendant, as an inducement to plaintiff to enter into and perform a contract for the sale of tin plates." It would seem from this wording that the American Steel Co. gave the bank a valuable consideration and thereby created a binding contractual obligation. As a matter of fact, the consideration was given to the bank by the applicant for the credit [MacDonnell-Chow Co.] and not by the beneficiary [American Steel Co.]. The court also accepted the wrong definition and classification of the letters of credit as explained before on p. 64. Fortunately this misconception does not vitally affect the decision in this particular case.

The case is further complicated by the content of the letter of credit, which was drawn incompletely in one respect, as it contained no date of expiration. The instrument was an irrevocable domestic letter of credit and the resulting drafts could

be dishonored only if the beneficiary had failed to comply with the terms of the credit. The court held that the payment could not be refused on the ground that the beneficiary had failed to observe provisions contained in the contract of sale, but not incorporated in the letter of credit. The two documents were regarded as separate and independent of each other. While the defendant bank lost the case, the decision is decidedly in favor of the interests of banks in general. They are thus freed from any responsibility of knowing the terms of the contract between buyer and seller. However, the conclusion that the letter of credit is a complete and independent document must be applied by American banks with utmost care. While they should have no direct concern in the merchandise, still they must exercise every precaution to protect the interest of their customers in compelling beneficiaries to comply with the exact terms of the credit. This case was cited in *Bank of Taiwan vs Gorgas-Piere Mfg. Co.*, 273 Fed. 660.

**V. A Bank Cannot Revoke Its Letter of Credit Because Drafts Presented by a Negotiator Have Been Drawn in Violation of a Sales Contract.**

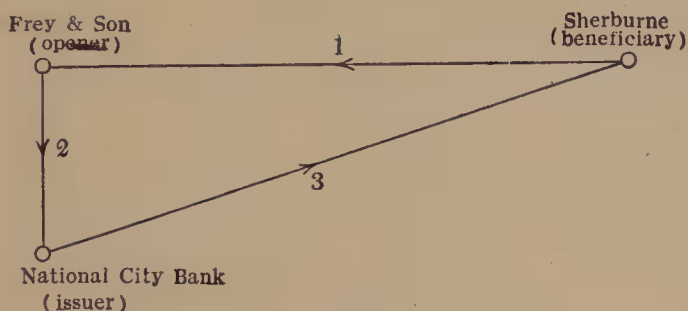


FIG. 5

1. Sherburne Co. and Frey & Son entered into a contract of sale covering shipments of sugar from Java to New York, payment to be made on presentation of warehouse receipts. The contract provided that "should any unforeseen circumstances as accidents, stress of weather, etc., prevent the steamer or steamers hereafter declared against this contract from clearing within the time specified above, and the seller or their agents be unable to supply other tonnage of equal character and capacity, the buyer has the option of canceling such portion of this contract, as has

not cleared within the time specified above or taking the sugar for later shipment without claiming damages."

2. Frey requested the National City Bank of New York to issue a letter of credit in favor of Sherburne.

3. The National City Bank gave Sherburne & Co. an irrevocable letter of credit authorizing them to draw sight drafts accompanied by warehouse receipts covering sugar, shipment to be made during certain specified months.

4. One shipment of sugar from Java according to the contract was to be made in July, but actually was not effected until August 15. Frey, therefore, exercised his option of cancellation under the contract, and rejected the shipment. Nevertheless the National City Bank notified Frey that it intended to negotiate the drafts drawn by Sherburne under the letter of credit. Therefore Frey asked the court to enjoin the beneficiary from drawing the drafts under the letter of credit and the bank from making payment of the drafts which might be in the hands of third parties.

*Decision.*—The injunction was refused. The opinion of the court read in part as follows:

✓ "The Bank issuing the letter of credit is in no way concerned with any contract existing between the buyer and seller. The Bank is only held liable in case of a violation of any of the terms of the letter of credit. . . .

✓ If the Defendant Sherburne & Co. violated its contract with the plaintiff, the latter has a remedy in action at law for damages against the defendant. . . .

Interests of innocent parties who may hold drafts under the letter of credit should not be made to suffer by reason of rights that may exist between the parties to the contract of sale in reference to which the letter of credit was issued. It would be a calamity to the business world engaged in transactions of the kind mentioned in this complaint if for every breach of a contract between buyer and seller, a party may come into a court of equity and enjoin payment on drafts drawn upon a letter of credit issued by a bank."

*Comment.*—The above case is based upon the relation between the contract of sale and the letter of credit, and upholds the principle of *American Steel Co. vs Irving National Bank*. The contract of sale between buyer and seller gave the former the

right to cancel the obligation if shipment were not effected before a certain date. This condition was not included in the letter of credit which was irrevocable in form. The instrument authorized the beneficiary to draw his drafts and the bank expressed its engagement to honor them in the usual statement which read: "We hereby agree with bona fide holders that all drafts, issued by virtue of this credit and in accordance with the above stipulated terms, shall meet with due honor upon presentation at our Export Commercial Credit Department if drawn and negotiated not later than the period indicated." The purpose of this statement in the letter of credit is to enable the beneficiary to negotiate his drafts with a local bank which then becomes a bona fide holder for value. The bank has no means of ascertaining the condition of the sales contract between the buyer and the seller. The bank, as an innocent third party which purchases drafts drawn in accordance with the provisions of the credit, has a right to demand payment from the bank issuing the letter.

The case in question represented a general attempt to prevent the operation of an irrevocable credit of a bank by means of a court injunction. As described before the collapse of the sugar market led to widespread cancellation of orders by the buyers, but in many cases the sellers had received irrevocable letters of credit. The nature of the letter of credit was not well understood by many importers and some of them sought to prevent the payment of drafts by obtaining a writ of injunction.

On this situation, Mr. Paul Warburg, chairman of the International Acceptance Corp., in an address made before a meeting of the American Acceptance Council, the fall of 1920, commented as follows:

"The decline in prices induces importers to bring pressure upon our banks to refuse to accept confirmed letters of credit which have been issued for the purchaser's account. In fairness it must be stated in their defense that in several cases they were themselves the victims of sharp practices on the part of foreign sellers, who had delayed or willfully omitted shipping the goods while the trend of the market was in favor of the purchaser, but who were using every legitimate, and often illegitimate, means to hurl the merchandise at the importer, when the contract had turned in the shipper's favor. But even where fraudulent or sharp practices of this sort were unfairly indulged in by such shippers, this cannot be permitted to affect the sacred pledge embodied in a

confirmed letter of credit, which must be respected in all and any circumstances as long as the terms and conditions of the letter of credit are being observed under which the accepting bank had issued the credit, no matter what loss this may possibly involve for the customer.

A bank that dishonestly refuses to fulfill its obligations under such a contract because it or its clients might suffer a loss or because such customers bring pressure upon it to disregard its sacred pledges, or even try to inveigle inexperienced judges into granting injunctions, in order to prevent the bank from giving its acceptances, ought to be held up to public contempt, and any bank found to connive or indulge in such immoral practices ought soon to learn that its acceptances have become unsalable in our own market as well as in foreign lands."

The motions for injunctions were based on the case of *Higgins vs Steinharter* (106 Miscellaneous 168). Higgins & Co., New York importers, requested Munroe & Co., New York bankers, to issue their letter of credit in favor of one Journet to cover a shipment of walnuts from Spain. The credit was to expire Nov. 7, 1913, before which date shipment was to be made. Journet presented a bill of lading purporting to evidence shipment on Oct. 30, 1918. Higgins & Co. informed Munroe & Co. that the bill of lading was fraudulent and that shipment had not been made until December. The former therefore notified the latter not to accept the drafts since they had been drawn after the expiration of the credit. Munroe & Co. stated their intention of accepting the drafts if the bills of lading on their face showed shipment prior to Nov. 7, 1918. Higgins & Co. therefore requested the court to issue an injunction restraining Munroe from accepting the draft.

The decision of the court reads in part as follows:

"Where the plaintiff's [Higgins] application for a letter of credit in favor of defendant Journet, to be used in payment for a shipment of walnuts purchased from him, provided that the credit should expire on a certain date, on or before which the shipment must be made, but it was in fact made a month later, an injunction *pendente lite* in an action to restrain the collection and payment of a draft drawn against the letter of credit and for its cancellation, on the ground that the defendant had defaulted on his contract, will be granted."

Although the bill of lading on its face evidenced shipment before the expiration date, the court went behind the document

and based its decision on an examination of the facts themselves. The court, was undoubtedly exceeding its powers in granting the injunction and was unjustified by the facts in the case. In fact, *Frey vs Sherburne* directly overrules *Higgins vs Steinhardt* by denying that a court can enjoin the operation of an irrevocable letter of credit.

A similar view was followed by Justice Cohalan in the case of *El Reno Grocery Co., etc., vs Lamborn, et al*, (*New York Law Journal*, Dec. 15, 1920). In this case the court vacated an injunction against the banks which had issued letters of credit. The opinion of the court reads as follows:

"There are before the court 24 motions for injunctions pendente lite in equity cases brought for the cancellation of certain contracts for the sale of sugar which the plaintiffs have attempted to rescind. The decision on this application is decisive of the 23 other motions. To enjoin the defendants from collecting upon a letter of credit established in their favor, because the plaintiff alleges there is a dispute, default or breach by the defendants of the contract, is for the court to make a new, different and distinct agreement between the parties herein. This the court is not prepared to do. In my opinion the plaintiffs have an adequate remedy at law and there are no substantial reasons shown for invoking the extraordinary remedy of an injunction order. The plaintiff's motion is denied and the injunction vacated."

The refusal of American courts to interfere with the operation of an irrevocable credit will undoubtedly strengthen dollar exchange. These decisions were rendered at a critical period in the development of American credits. Their value had to some extent been weakened in South America and in the Far East by certain repudiations, but these impairments have been overcome in part by the recognition in American courts that an irrevocable letter of credit shall not be restricted by injunctions. See also *National Park Bank vs Old Colony Trust Co.*, 114 *Miscellaneous Reports*, New York, 127, *Lemon Importing Co. vs Garfield Savings Bank*, 173 N. Y. Supp. 551 (1919), *Imbrie vs Nagase*, 187 N. Y. Supp. 692 (1921).

VI. An Issuing Bank May Revoke Its Letter of Credit if Drafts Presented by the Negotiator Are Drawn in Violation of the Credit.

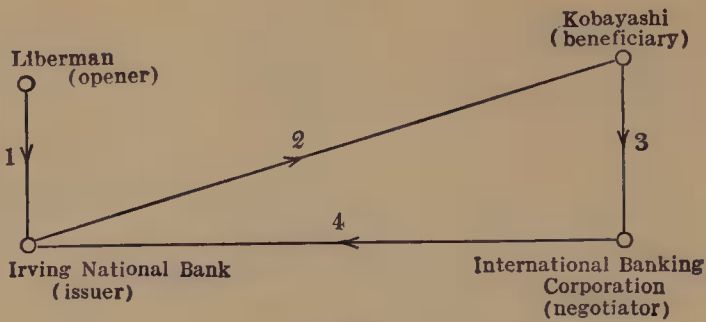


FIG. 6

1. Liberman, an American importer, applied to the Irving National Bank to issue its letter of credit in favor of Kobayashi, a Japanese exporter of silk.

2. The Irving National Bank (at that time also the Irving Trust Co.) thereupon issued to Kobayashi the following letter:

"Irving Trust Company,  
New York, Nov. 7, 1919."

Letter of Credit

No. 2110

For \$32,500 U. S. C'y

We hereby authorize K. Kobayashi, Yokohama, Japan, to draw on Irving Trust Company, New York, for account of Philip Liberman, New York, at four months after sight for any sum or sums not exceeding in the aggregate Thirty-two Thousand Five Hundred Dollars United States Currency, against complete negotiable set of shipping documents covering 500 pes. Fuji silk as per sample 400 weight about 16 mm. each piece 33 inches x 50 yds. to be made as per our designs and total width of stripes not more than 50 per cent of the material width. Price \$65.00 United States Gold per piece c.i.f. New York for shipment to New York. Marine Insurance and also War Risk Insurance to be effected by shippers. Drafts under this credit are to be drawn in duplicate and negotiated on or before May 20, 1920, and to be endorsed: 'against I. T. Co.'s L/C 2110 dated New York Nov. 7, 1919,' and the amounts thereof to be written off on the back of this Credit. The negotiating banker must send duplicate advice of such drawings promptly to Irving Trust Co., New York, accompanied by negotiable Bills of Lading (all, except one of the set issued), Insurance Certificates if the shipper insures, Consular Invoice and Commercial Invoice. Bills of Lading are to be issued to the order of 'Irving Trust Co., New York, Notify Philip Liberman, New York.' All remaining documents, completing the sets originally issued, must be sent by nego-

tiating banks to Irving Trust Co., N. Y., and we hereby agree with the drawers, endorsers and *bona fide* holders of drafts drawn under and in compliance with the terms of this Credit that the same shall be duly accepted upon presentation and paid at maturity.

IRVING TRUST CO."

3. Kobayashi negotiated his drafts and documents with the International Banking Corp.

4. The International Banking Corp. presented the drafts to the Irving National Bank which declined to accept them for the reason that the invoice did not "contain the specific statement in words or figures called for in the credit, stripes not more than 50 per cent of material width." The issue between the two banks was whether or not the draft and shipping documents complied with the terms of the letter of credit.

*Decision.*

"A bank issuing a letter of credit authorizing the drawing of drafts upon it against documents may refuse to honor such drafts unless the documents so exactly comply with the requirements set forth in the letter of credit that the bank need not determine arguable questions in construing such letter of credit.

"When the bank issued this letter of credit, it did not purchase goods. It agreed to purchase documents in the sense that it would pay on receipt of certain documents which should conform in every respect with the requirements of the letter of credit. It was, of course, not concerned with the goods but with the documents.

It would greatly impair the business of issuing letters of credit, if banks were required to construe the documents involved and determine arguable questions.

Of course, there are cases where simple and obvious verbal errors are made such as 'our' above illustrated, of which advantage cannot be taken; but here is a real difference of opinion which is not a matter of mere words.

The only safe rule for a bank is to refuse to pay if by omitting, as here, a distinct and clearly expressed provision, the documents do not conform with the letter of credit."

*Comment.*—The decision in this case is evidently based on the early case of *Bank of Montreal vs Recknagel*. It would indeed have been unfortunate had the court rendered any other decision than that actually given, for a bank cannot be expected to as-

sume responsibility for the many technicalities which arise in mercantile practice.

### VII. An Issuing Bank May Revoke Its Letter of Credit if Drafts Presented by the Beneficiary Are Drawn in Violation of the Credit.

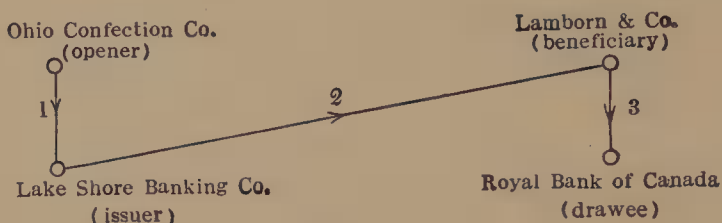


FIG. 7

1. The Ohio Confection Co. of Cleveland requested a local bank, the Lake Shore Banking & Trust Co., to issue a letter of credit in favor of Lamborn & Co., sugar importers of New York.

2. The bank made arrangements with its city correspondent, the Royal Bank of Canada, to have the latter honor the drafts of Lamborn & Co., and then sent this firm the following letter of credit:

"We hereby authorize you to value on the Royal Bank of Canada, New York City, for account of The Ohio Confection Co., Cleveland, Ohio, up to an aggregate amount of twenty-six thousand five hundred sixty-one and ninety-two cents available by your drafts at sight against Bills of Lading for 550 bags Java White *Granulated* Sugar, 224 pounds to the bag, price 22 cents less 2 per cent duty paid, f.o.b. cars Baltimore, Maryland. Landed Weights, August and September delivery from Java.

Bills of lading for such shipment must be made out to the order of the Lake Shore Banking & Trust Co. of Cleveland and together with invoice, must accompany the drafts.

The amount of each draft negotiated together with date of negotiation must be endorsed on back hereof.

A *duplicate of such Invoice*, together with one copy of Bill of Lading must be sent by the bank or banker negotiating draft direct to the Lake Shore Banking & Trust Co. of Cleveland, by mail, attaching to the draft a statement to this effect.

Any draft drawn under this credit must state that it is 'drawn under Letter of Credit L. S. B. & T. No. 102 dated Cleveland, May 21st, 1920,'

and must be advised to the Lake Shore Banking & Trust Co., Cleveland, Ohio.

We hereby agree with bona fide holders that all drafts issued by virtue of this credit and in accordance with the above stipulated terms shall meet with due honor upon presentation at the office of the Royal Bank of Canada, New York City, if drawn and negotiated on or before Nov. 15, 1920."

The bank refused to honor the drafts because the terms of the credit had been violated in the following respects:

a. Bills of lading covered "Java white sugar" not "granulated" and were made out to the order of Lamborn & Co. and not to the bank.

b. Invoice was not sent to the bank.

c. Drafts were drawn for full amount "with exchange," thus calling for an amount in excess of the credit.

*Decision.*—A party entitled to draw against a letter of credit must strictly observe the terms and conditions under which the credit is to become available, and if he does not, and the bank refuses to honor his drafts, he has no cause of action against the bank. ✓

*Comment.*—This case involves one of the many domestic letters of credit opened during 1920 when sugar was the basis of frantic speculation. Inland firms desirous of purchasing sugar requested their local banks to open domestic letters of credit in favor of sugar importers, situated usually in New York City. When the sugar market collapsed, many of the interior firms sought to cancel the credits which were usually irrevocable in form. In the above case, the opener of the credit was justified in refusing to honor the beneficiary's draft, even though drawn under an irrevocable credit, for the terms were not observed in several respects. The last two cases all involve the same principle that the terms of a credit must be observed. They differ merely as to parties, the former being concerned with the repudiation of drafts presented by a negotiating bank, the latter by the beneficiary himself.

#### **VIII. An Issuing Bank Is Liable to the Opener of a Credit if the Terms Are not Observed by the Beneficiary.**

1. Recknagel & Co. of New York City requested a letter of credit from the New York office of the Bank of Montreal in the following words:

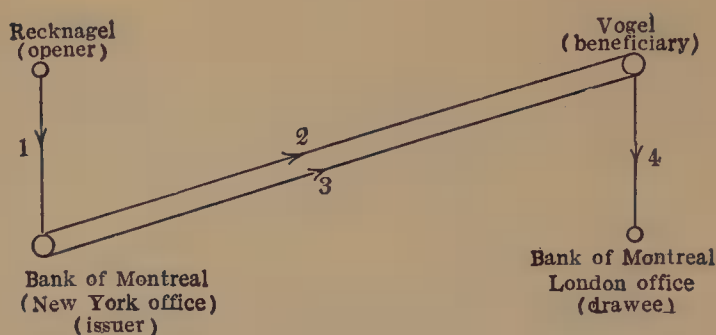


FIG. 8

"Please telegraph authority to Vogel & Co., Hong Kong, to draw at six months for our account against consular invoice, and full set bills of lading of 2,500 bales of manilla hemp, p. Robinson, at the rate of £4 p. bale on a basis of eight shillings sterling freight filled up in bill of lading, reducing advance if higher."

2. The bank immediately sent Vogel the following telegram:

"Vogel, Hong Kong, credit 608, six months, issued Recknagel ten thousand pounds, documents; 2,500 bales manilla hemp, per Robinson, at four pounds per bale, if freight, eight shillings, or reduced advance if freight higher."

3. The bank delivered to Recknagel a letter of credit in favor of Vogel who was authorized to draw on the London office. The drafts were to be drawn

"against goods shipped per 'Robinson' . . . at 6 months' sight, for any sum or sums not exceeding £10,000 sterling, to be used as they may direct for invoice cost of 2,500 bales of manilla hemp, . . . to be purchased for account of Recknagel & Co., of New York, or whom it may concern, and to be shipped to New York. The bills must be drawn in Hong Kong, or in some port in ———, prior to the 1st day of June, 1882, and advice given to you in original and duplicate, such advice to be accompanied by bill of lading, filled up to order of agents of the Bank of Montreal, New York, with abstract of invoice indorsed thereon for the property shipped as above. All the bills of lading issued, except the one mailed to us and the one retained by the captain of the vessel carrying the cargo, are to be forwarded direct to you. The original invoice properly certified, to be also forwarded to us." On the margin was written, "This credit, opened by cable direct 1st December, 1881."

Upon the receipt of this letter of credit, Recknagel executed

a credit agreement in part "to provide for all bills which shall be drawn and accepted under the same."

4. Vogel drew on the London office of the Bank of Montreal drafts "against . . . . . bales of hemp." The drafts were accompanied by bills of lading for "bales of merchandise," but upon each bill of lading, after it had been signed by the captain of the vessel and without his knowledge or consent, there was added an abstract of invoice for "bales of manilla hemp." The drafts were also accompanied by a letter of advice describing the receipt of "bales of hemp."

The London office accepted the drafts and paid them at maturity.

When the vessel arrived at New York, an examination of the shipment showed that it was composed of only 500 bales of manilla hemp and the remaining 1,520 "bales of merchandise" was made up of rolls of matting.

Vogel went into bankruptcy and absconded.

Recknagel refused to reimburse the bank which thereupon brought suit.

*Decision.*

"If Vogel & Co., in drawing upon the plaintiff's (Bank of Montreal) London agent, complied with the terms and conditions of the cable credit, then the defendants (Recknagel & Co.) are liable to the plaintiff; for that credit was extended in pursuance of the terms of their request. But if Vogel & Co., in any material manner, failed to comply with those terms and conditions, the plaintiff's London agents accepted the drafts at their peril. . . .

The plaintiff was only entitled to judgment for the amount of the draft which was accompanied by a bill of lading for the bales which were manilla hemp. . . . defendant's agent (in London), in accepting against a shipment of merchandise or of hemp generally, departed from an important condition of the credit and (credit) agreement."

*Comment.*—In the above case the bank accepted drafts accompanied by bills of lading which did not cover the goods described either in the agreement between the importer and the bank or the letter of credit to the beneficiary. Hence the importer was within his rights in refusing to reimburse the bank for the outlays which it had made.

**IX. A Bank Negotiating Drafts Under a Letter of Credit Is Not Responsible for the Quality of the Merchandise Shipped by the Beneficiary.**

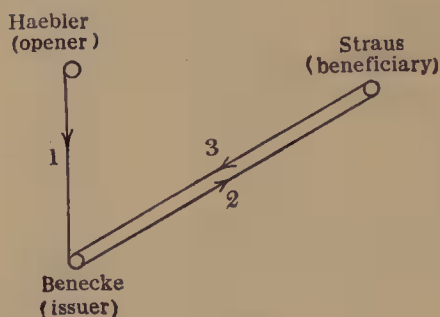


FIG. 9

1. Haebler, a New York importer, applied for a letter of credit from Benecke, a London banker, in the following communication:

"Please issue a letter of credit for account of ourselves, in favor of Anton Straus . . . for any sums not exceeding about Eight Hundred Twenty-five Pounds Sterling. Drafts to be drawn at 3 months' date from date of bill of lading against shipment by steamer or steamers to New York, direct or otherwise, for invoice cost of 1,000 bags beans. Bills to be accompanied by full set, in due course, of blank indorsed bills of lading to order, and original invoice certified by the United States Consulate."

2. Accordingly Benecke issued a letter of credit to Straus, an exporter doing business in Budapest.

3. Straus drew drafts with accompanying documents on Benecke who accepted and paid them. The documents covering the goods were delivered to Haebler on his signing a letter of lien (trust receipt). After inspecting the beans, Haebler rejected them because of inferior quality. The beans were sold but failed to realize the amount of the drafts and so Benecke sued Haebler to recover the deficiency. Haebler acknowledged the receipt from Benecke of the invoice and bill of lading for the beans consigned to Benecke "as per their letter of credit B, No. 501 — and the said shipper (Straus) having drawn upon Messrs. Benecke, Sonchay & Co. for £813.7.8 on the said invoice. We [Haebler and his associates] agree to hold the above-mentioned goods or the proceeds thereof as the property of Messrs.

Benecke, Souchay & Co. until we have covered the amount drawn for by proper remittances.”

*Decision.*

“The letter constituted an approval by the vendee (Haebler) of the bankers’ acceptance of the drafts drawn by the vendor (Straus) and a plain admission that both draft and acceptance were regular and in accordance with the terms of the vendee’s letter of request, and that the latter could not thereafter contend that it was their intention, in directing the issue of the letter of credit, that the bankers should stand merely as guarantors of bills drawn by the vendor on the vendee.

The fact that the merchandise delivered by the vendor was inferior to that contracted for, did not affect the vendee’s liability for moneys paid by the bankers upon their acceptance, as the kind and quality of the merchandise to be furnished by the vendor was not defined in the vendee’s application for the letter of credit, and no duty devolved upon the bankers to ascertain, before accepting the vendor’s drafts, whether the goods shipped corresponded in quality with the goods ordered.”

*Comment.*—The function of the banker in financing a transaction in foreign trade is to assume a credit risk. He is acting as a guarantor of the credit of the buyer and gives assurance to the seller that he will be paid regardless of the ability of the buyer to make reimbursement. The banker, as pointed out in the above decision, cannot be expected to assume the commercial risk of certifying to the quality of the merchandise.

The principles in the above cases will be summarized in parallel form at the close of Chap. X, which presents a survey of British cases in letters of credit.

## CHAPTER VIII

### THE AUTHORITY TO PURCHASE

**I. Meaning.**—Previous chapters have presented the various aspects of the letter of credit. Consideration will now be directed to the “authority to purchase,” an instrument which performs a function quite similar in the financing of foreign trade. In fact, both these two documents are the means of shifting the burden of financing an overseas transaction from exporter to importer. This fact renders them of special significance to American foreign trade, which today consists more largely of exports than of imports. The letter of credit is of major importance since it is applied in financing trade with all the world, while the authority to purchase has less interest, for its use is mainly confined to commerce with the Orient. In this field, however, it plays a commanding rôle, for exports to the Far East, especially to China, are financed to a large extent by the authority to purchase. Because of its specialized use, this instrument has received scant attention from writers on foreign trade, and even works on Far Eastern banking have given it but slight consideration.

The financing of an overseas transaction by the importer rather than the exporter is performed either through a letter of credit or an authority to purchase. In the Far East, where banking facilities have until recent years been quite limited, it has often been impossible for an importer to secure bank credit for the financing of his business. To meet this need, the authority to purchase or, as known in its abbreviated form, the A/P was developed. Its operation may be illustrated by describing the financing of a shipment of automobile trucks from an American exporting company to a Chinese importing concern. As the transaction is not to be financed through a letter of credit, the exporter cannot draw his drafts on a bank, but must address them to the importer himself. It may, however, prove difficult to find a bank which cares to purchase such trade bills, and hence the exporter normally has no other choice but to forward

his drafts for collection. This applies especially to a shipper whose credit is so limited or overburdened that he is unable to secure accommodation from a bank in financing his transaction. In order to create a market for the shipper's drafts, the importer is then called upon to finance the transaction by an authority, or as it is sometimes called a letter of instruction. This he does first by informing a bank in his own country that he has authorized the exporter to draw his drafts, and then requesting the bank to arrange for the negotiation of these bills by a branch or a correspondent located near the exporter.

The importer, of course, assures his bank that he will provide funds for the retirement of these drafts at maturity, and also that he will reimburse the bank for its services. This document which the importer addresses to his bank is frequently confused with the authority to purchase. It is, however, a separate instrument and may better be termed a "letter of guaranty." It is quite similar to the combined form of application and guarantee sometimes used in requesting a bank to issue a letter of credit. If the Far Eastern bank acts favorably on the application of the importer, it will then send to its American branch or correspondent a communication instructing the latter to negotiate the drafts drawn by the exporter in America on the importer in the Orient. It is the general practice to cable this information to the negotiating bank and later to send a letter with complete details. This letter constitutes the true authority, also known as the "authority to negotiate" or the "advice to purchase." It is entirely distinct from the "authority to draw" sent to the exporter by the importer. It is also different from the "advice of authority to purchase" forwarded by the negotiating bank to the exporter for the purpose of informing him that he has been authorized to draw drafts on the importer, and that the bank has been instructed to negotiate his bills on the presentation of proper shipping documents. This "advice of authority to purchase" may of course be sent directly to the exporter by the bank in the Orient, but it is more customary to forward the communication indirectly through an agent, whether a branch or a correspondent, located in the exporter's city. As the "advice of authority to purchase" is thus a communication from a bank to a beneficiary, it performs the same function as an advice of a letter of credit and so is frequently styled a "Chi-

nese" or "Oriental" letter of credit. Therefore in financing a shipment under the "authority" method, four separate documents are actually involved. The first is the communication sent by importer to exporter in which the latter is advised of the terms of sale and the right to draw drafts on the former. This document is known as an "authority to draw" but it is of no direct interest to the banks, for it is merely part of the commercial contract between buyer and seller. The term "authority to draw" often refers also to the letter of instruction in which the importer permits the bank to draw upon him as a means of reimbursement for paying the drafts of the exporter. Banks are more concerned in the remaining documents, namely, the letter of guaranty addressed by the importer to the Far Eastern bank, the authority to purchase forwarded by the Far Eastern bank to its American agent or correspondent, and the advice of authority to purchase sent by the American agent to the beneficiary.

✓ **II. Classification.**—Authorities, the same as letters of credit, may be classified along such principles as: (1) direction of shipment, (2) tenor of drafts, (3) form of currency, (4) privilege of cancellation, and (5) right of recourse. Although the instrument may be used to finance either an export from or import to the United States, in actual practice the authority is largely applied to the movement of exports. Therefore, while American banks perform the duties of notifiers of authorities and negotiators of drafts, they rarely, if ever, act as issuers. As to tenor, although drafts instructed under an authority may be drawn ✓ either at sight or on time, the latter is generally done. About 85 per cent of all drafts drawn under authorities are made on a time basis which may run for 60, 90, or 120 days' sight. Furthermore, the drafts are payable not in Oriental currency but ✓ in United States money, and the exporter usually receives the full amount of the bills. In short, drafts made under authorities are ordinarily based on export transactions, are drawn on a time basis and are made payable in United States currency.

It is, however, more difficult to classify the authorities from the standpoint of the right of cancellation. It will be recalled from the previous analysis of letters of credit that these instruments, grouped on the principle of whether they can be revoked, are classified as follows:

1. Irrevocable by issuer and confirmed by notifier.
2. Irrevocable by issuer and unconfirmed by notifier.
3. Revocable by issuer and unconfirmed by notifier.

The same classification may also be applied, with certain modifications, to the authority. As mentioned above, the authority is not ordinarily sent by the issuing bank directly to the beneficiary, but is more usually transmitted to him through a second notifying bank. Therefore the subject of confirmation is theoretically of importance. However, this question loses some of its significance through the fact that an authority is generally opened by a domestic agency of the foreign bank which has originally issued it, thus making confirmation a useless formality. An authority may be irrevocable by the issuing bank and further confirmed by the notifying institution, in which case it has the same force as a letter of credit, for it then constitutes the direct obligation of both issuing and notifying banks to negotiate the bills of the beneficiary and can be rescinded only with his consent. The form of authority transmitted in this case by the notifying bank to the beneficiary contains an address which unequivocally informs him that the bank has been authorized to pay his drafts and that his right to draw these bills continues until a fixed expiration date. The notifying bank is not always requested to confirm the authority, and in this event it is unconfirmed as far as the notifier is concerned but still irrevocable by the issuer.

In this contingency the advice which the notifier communicates to the beneficiary may assume the following form:

"We beg to advise that we are today in receipt of instructions from our correspondent, the Canton Bank, authorizing us on behalf of the Chinese Importing Co. to negotiate your 90 day documentary drafts."

At the same time this advice specifies the expiration date for the authority, but is careful to add a statement that it is subject to cancellation. The form used by one American bank states definitely its relation to the entire transaction in this manner:

"We have no instructions to confirm this advice and make no representation that we have funds in our possession applicable to the payment of said drafts and reserve the right to cancel this notice or refuse to negotiate any drafts presented in accordance herewith at any time."

The third form of the authority is revocable by the issuing and unconfirmed by the notifying bank. This document is quite similar in wording to the advice of an irrevocable unconfirmed authority. Banks naturally hold that the unconfirmed authority may be revoked at any time prior to the negotiation of drafts drawn by the beneficiary. This view is usually expressed in the advice to the recipient in a statement that the authority may be canceled upon notice to that effect. Nevertheless, this is a right which a bank should exercise with utmost care, especially in dealing with an exporter manufacturing or preparing goods not staple in character and therefore limited in marketability.

It appears that, before the war, authorities were generally revocable in form, but from 1914 until 1920 sellers of goods were in a position to demand irrevocable obligations. This was a natural result of the period of rising prices and the sellers' control over market conditions, but in the present movement of receding prices, with the consequent return to ascendancy on the part of the buyers, it appears that Far Eastern importers are insisting that American exporters accept revocable rather than irrevocable authorities.

In turning the discussion from the subject of cancellation to that of recourse, it must be borne in mind that a relation does not necessarily exist between these two principles. The question of cancellation affects the authority before negotiation of the authorized drafts, while the subject of recourse enters into consideration only after the purchase of these bills. At this point it may be mentioned that the Law of Negotiable Instruments permits the drawer of a draft to add after his signature the expression "without recourse" and in consequence of this act he is relieved of the usual liabilities of a drawer in the event that his bill is dishonored by the drawee. The subject of recourse under letters of credit has already been discussed before. Although the letter of credit seldom contains any reference to recourse, there is no practical recourse on the drawer of drafts, but it is customary to insert in the authority sent to the beneficiary a sentence which reads somewhat as follows:

"Please note that this advice is NOT to be considered as being a bank credit and does not relieve you from the ordinary liability attaching to the drawer of the bill of exchange."

Even if this statement is omitted, it is the usage among banks to regard drafts drawn under authorities as carrying full recourse to the drawers until the bills have been honored by the drawees. This implication naturally may be nullified by inserting in the advice to the beneficiary an expression which permits him to specify on his draft that it has been drawn without recourse on himself.

The question of recourse among the various parties to an authority will be more clearly understood by tracing a complete transaction financed under this method. In the first place, the exporter draws his draft on the importer and presents this bill together with his documents to the local bank which has notified him of the authority. This bank examines the documents, and if they are correct in form, it gives him a check for the amount of the draft. As the paying bank is acting on behalf of its foreign branch or of a closely affiliated institution, it debits the account of this Far Eastern bank and forwards draft and documents for acceptance. Upon receipt of these documents, the issuing bank presents them to the importer for his acceptance and again at maturity for ultimate payment.

If the importer meets his obligations the entire transaction is closed, but if he dishonors the draft either at the time of their acceptance or payment, the question of recourse immediately arises. In the first place, if the Far Eastern bank has issued the authority directly to the drawer, it reserves full recourse. However, it is more customary, as seen above, to transmit the authority to the beneficiary through an American notifying bank which takes the position that it is merely an agent of the foreign issuer and therefore has the right of action on the drawer. Lastly, as to the relations between negotiator and issuer, there is entire agreement among banks that the former has full recourse upon the latter until final payment. The negotiating bank further protects itself usually by stamping upon the drafts the declaration that it in no way holds itself responsible for the ultimate fate of the bills. The sole liability which the negotiating bank incurs is its vouching for the correctness of the shipping documents. The question of recourse between issuer and notifier in actual practice is really of small importance, because these two institutions usually stand in relation of home office to branch or agency.

Regarding relations between the right of recourse and the right of cancellation, there appear to be two divergent views among bankers. Some contend that a revocable authority necessarily gives rise to the drawing of drafts with recourse, while an irrevocable instrument by implication permits the drawing of drafts without recourse. However, as observed above, it is the general opinion that there is no relation between these two subjects, and authorities theoretically may be issued in four types: (1) Revocable without recourse, (2) revocable with recourse, (3) irrevocable without recourse, (4) irrevocable with recourse. The first type is rarely found while the second is widely used. The third form assures the beneficiary that his drafts will be negotiated within a certain time limit and that his bills may be drawn without recourse to himself. As far as he is concerned the instrument is practically a confirmed letter of credit and seldom appears under the name of authority. However, the second and fourth offer little protection to the recipient, for even in the latter case, although the authority may not be canceled, still there is always recourse on him if his drafts are dishonored by the drawee.

In summary, most authorities in practice are revocable in form and call for drafts carrying full recourse on drawers.

**III. Forms.**—As explained above, the financing of a shipment under an authority involves the issuing of several separate instruments; the letter of guaranty to the issuing bank, the authority to purchase to the notifying agent, the advice of authority to purchase to the beneficiary and others. These communications may be sent as ordinary letters, but it is customary for banks which handle many of these transactions to use set forms such as those presented below.

(1) APPLICATION FOR AUTHORITY TO PURCHASE.—Time draft.

April 30, 1922.

TO THE X BANK,  
Canton, China.

DEAR SIRs:

I/We shall feel obliged by your forwarding instructions by cable/letter to your Agents in *New York* to purchase draft or drafts as follows:

Drawn by *American Export Co.*

Upon *Chinese Import Co.*

At usance of *90 days sight*

To the extent of *\$5,000.00* say *five thousand dollars U. S. currency*

Against a shipment or shipments of *3 automobile trucks*

Not later than *Aug. 31, 1922*

accompanied by a full set of shipping documents relating to the above-mentioned merchandise ordered by me/us, viz:

Invoices *3 copies of invoices*

Bills of Lading *3 original copies of bills of lading*

Policies of Insurance *Certificate of Insurance made out in the United States*

In consideration of your granting me/us above request I/we hereby undertake to hold myself/ourselves liable to you as per conditions set forth in the Letter of Guarantee signed by me/us, and also I/we engage that I/we shall pay the amount at exchange of..... plus interest accrued thereon at the rate of 7 per cent per annum.

Yours faithfully,

.....  
Manager, Chinese Import Co.

(2) APPLICATION FOR AUTHORITY TO PURCHASE.—Sight draft.

April 30, 1922.

TO THE X BANK,  
Canton, China.

DEAR SIRs:

I/We request you to forward instructions by mail/cable to your *New York Branch Office* to pay to *American Export Co.* at *90 days' sight* any sum or sums not exceeding in all *\$5,000.00* say *five thousand dollars United States Currency* against his/their receipt or receipts, accompanied by a full set of shipping documents, viz:—Bills of Lading, Invoices, and Policies of Marine Insurance, covering the shipment of *3 Auto Trucks* ordered by me/us, and for the reimbursement of the amount so paid, your above-mentioned office to draw upon me/us, in *Canton* at usance of *90 days* after sight, within three months from this date. Stamp duty for the draft will be borne by me/us, and may be added to the amount of draft. The draft is to be drawn in *U. S. currency*, payable at the Bank's drawing rate for Demand Draft on *London* with interest.

In consideration of such draft or drafts being drawn by your Bank, I/we hereby engage duly to accept and pay the same at maturity, and guarantee that I/we shall not cause you any loss or trouble in consequence of such shipment or shipments being delayed or the goods turn-

ing out on arrival to be of defective quality or wrong description, or under any circumstances whatsoever.

Yours faithfully,

.....  
Manager, Chinese Importing Co.

I/We hereby guarantee the due performance of above contracts and take all responsibilities in connection therewith.

(3) LETTER OF GUARANTY.

To THE X BANK,  
Canton, China.

DEAR SIR:

We beg to inform you that we have authorized the American Exporting Co. to draw on us with recourse to the extent of \$5,000 at 90 days' sight for invoice cost against the following documents:

Bill of lading, 3 original copies

Insurance certificates, issued in United States

Invoices, 3 copies

Consular invoice,

to cover shipment of auto trucks from New York to Canton.  
and indorsed in blank

Bill of lading to order of X Bank.

prepaid

by shipper

Freight to be ..... Marine insurance .....

We agree,

1. To accept upon presentation all bills drawn pursuant hereto.
2. To hold the X Bank harmless because of any damage to merchandise shipped or deficiency or defect therein or in the documents above described.
3. That the said documents, or the merchandise covered thereby, and insurance shall be held as collateral security for due acceptance and payment of any drafts drawn hereunder, with power to the pledgee to sell in case of nonacceptance or nonpayment of the draft to them attached, without notice at public or private sale and after deducting all expenses, including commissions connected herewith, the net proceeds to be applied toward payment of said drafts. The receipt by you of other collateral, merchandise, or cash, now in your hands, or hereafter deposited, shall not alter your power to sell the merchandise pledged and the proceeds may be applied on any indebtedness by us to the bank due or to become due.
4. To pay your commission of 7 per cent for negotiating of drafts hereunder.

This engagement to commence from date hereof and to apply to all bills drawn within 3 months.

Please advise by .....  
cable

Yours faithfully,  
MANAGER CHINESE IMPORTING Co.

(4) AUTHORITY TO PURCHASE.

Expires on Aug. 31, 1922

TO THE MANAGER THE Y BANK.

DEAR SIR:

You are hereby instructed to negotiate drafts drawn by the American Exporting Co. on the Chinese Importing Co. at 90 days' sight to the extent of \$5,000 against shipment of automobiles to Canton within 4 months from this date.

Each draft must be accompanied by a full set of shipping documents, consisting of invoice, bills of lading filled up to order, and blank indorsed. Certificate of Origin required. Insurance (marine) policy to accompany the draft.

.....  
in China.

This instruction not being a bank credit is revocable and does not release drawer from liability.

All drafts drawn under this A/P must be marked as drawn under A/P No. 100 dated April 30, 1922.

Kindly advise the beneficiary of the above and oblige.

Yours faithfully,

For the X Bank,

.....,  
Manager.

(5) ADVICE OF AUTHORITY TO PURCHASE.

April 31, 1922.

AMERICAN EXPORTING Co.,

DEAR SIR:

We beg to inform you that we have been authorized by X Bank at Canton to negotiate your bills on Chinese Importing Co. to the extent of \$5,000 for full invoice cost of 3 automobiles shipped to Canton.

The bills are to be drawn in duplicate at 90 days' sight and must be accompanied by full set of bills of lading, invoices, and marine insurance policies, all in duplicate.

Shipping documents must be made out to "order" and blank indorsed.

The above documents must be duly hypothecated to the bank against payment of the bills.

Please note that this advice is not to be considered as being a "bank credit" and does not relieve you from the ordinary liability attaching to the "drawer" of a bill of exchange.

All drafts under this authority to purchase to be marked: "Drawn under A/P No. 1" with interest added thereto at 7 per cent per annum, from date hereof to approximate due date of remittance in New York. Payable at the current drawing rate for the X Bank's drafts at sight on New York.

Kindly hand in this letter with your drafts in order that the amount of same may be indorsed on the back hereof.

This authority expires on August 30, 1922, but is subject to cancellation by our giving you notice to such effect.

Yours faithfully,

For the Y Bank,

.....  
Manager.

#### (6) ADVICE OF NEGOTIATION OF DRAFT.

DEAR SIRs:

We beg to advise you that we have today negotiated Bill of Exchange No. 100 for \$5,000.00 drawn by American Export Co., on Chinese Import Co., under your Credit No. 100 dated April 30, 1922, and beg to hand you herewith undermentioned documents relating to same, the receipt of which you will please acknowledge and oblige us.

.....,

Form 1 is simply an application in which the importer requests the bank to purchase a time draft drawn by the exporter. Form 2 instructs the bank to arrange for the payment of a sight draft; reimbursement is obtained by the bank drawing on the importer. The importer stipulates the conditions under which the authority shall be issued. These terms describe the form of drafts and the kind of documents. The expiration date is usually determined by the period within which the drafts are to be drawn.

Form 3 is a guaranty whereby the applicant agrees to accept the drafts on their presentation, to pay the commission, to absolve the bank from all responsibility for the condition of documents or goods and to pledge the merchandise as collateral.

Form 4 is the authority to purchase sent by the issuing bank to its branch or foreign correspondent. This institution then sends the beneficiary an advice such as Form 5. After his drafts have been negotiated by the advising bank it sends a statement such as Form 6 to the issuing bank.

It is unnecessary to enter into a detailed analysis of the forms of the authority to purchase and the authority to draw, for their general characteristics have been studied above, and besides, these instruments have features similar to the letter of credit.

It will therefore be sufficient to confine the examination of forms to those characteristics which are peculiar to authorities. The letter of credit usually specifies that bills of lading must be indorsed directly in favor of the bank negotiating the drafts, but the authority generally calls for the drawing of these documents to order and indorsed in blank. Although the bills of lading are thus negotiable in form, the paying bank's title to all the documents is fully recognized by having the shipper sign an hypothecation certificate. ✓

As the drawer of the drafts receives payment for their full amount without the deduction of any discount, and as the paying bank immediately debits the account of the issuing bank, the latter is therefore entitled to interest from the date of payment. Provision is made for this charge by inserting on the bill the so-called "Far Eastern interest clause" which reads as follows: ✓

"Payable at the collecting bank's rate for sight drafts or ..... with interest from date of draft until date of approximate return of proceeds of the draft."

The authorities as a rule provide space on the reverse side for entering details of drafts negotiated, but banks apparently do not insist upon these entries in case of "without recourse" authorities. In fact, the only purpose of such records is to prevent a beneficiary from negotiating his drafts several times at different banks and thus overdrawing the amount allowed him. However, this difficulty does not arise in the case of the authority, since the advising bank alone is designated as the paying agent, and therefore no other bank would be likely to negotiate the drafts. For the same reason it is also unnecessary for a bank to demand the return of an authority of which the amount has ✓

not been exhausted, since it cannot very well be misused after its expiration if irrevocable, or after cancellation if revocable.

**IV. Comparison Between the Authority and the Letter of Credit.**—The above analysis has presented the meaning, classification, and forms of the authority and it now remains to compare this document with the letter of credit. The function of these two instruments is the same because they both transfer the burden of financing a transaction from the exporter to the importer or his bank. Both documents enable the exporter to receive reimbursement for his goods on presentation of the proper documents, and therefore both the authority and the credit letter are in a way *d/p*, or documents on payment instruments. The underlying principle is the conferring upon the exporter of the right to draw drafts. In fact, the similarity between the two instruments has led a number of bankers and exporters to call an unconfirmed letter of credit an authority to purchase. In order to avoid confusion in terminology there is a tendency among banks engaged in Oriental trade to issue only two instruments, an irrevocable letter of credit and a revocable authority. A further point in common may be noted in the various documents ancillary to both the letter of credit and the authority. In financing a shipment under either of these two methods, it is necessary to employ a letter of guaranty from the importer to the issuing bank, a communication between issuing and notifying bank, and an advice from the notifying bank to the beneficiary.

The letter of credit and the authority, however, differ widely as to actual use, for in general the latter is far more specialized. As mentioned above the letter of credit is used to finance trade with all countries and to cover import as well as export transactions. On the other hand, the authority is applied mainly to Far Eastern commerce and is used almost exclusively to facilitate exports from the United States. Under letters of credit, drafts may be drawn either at sight or on time, in dollars or in sterling and other foreign currencies. However, bills executed by virtue of authorities are usually made on the acceptance basis, and because of the uncertain nature of Far Eastern currencies in the past, it is the rule for American exporters to insist upon payment in United States money. The letter of credit may be handled through any correspondent, but the authority is opened

mainly with branch banks or other closely associated institutions. Comparing the two documents from the viewpoint of cancellation and of recourse, it was observed above that the letter of credit is usually irrevocable and allows the drawing of drafts practically without recourse on the beneficiary. However the authority is usually revocable in form and the issuing bank generally retains the right of recourse to the drawer. Last, the fundamental distinction lies in the fact that the authority is not the evidence of a bank credit. Banks at times erroneously describe their authorities as "credits," but this instrument in no sense is the undertaking of the issuing institution. While the letter of credit imposes the burden of financing the transaction upon the bank, the authority places this obligation upon the importer himself. In the first place, the accredittee is given the right to draw on the importer, and as time bills are usually made, these in consequence become trade acceptances. Because of the superior credit standing of the drawees, bankers' acceptances under letters of credit may be freely sold in the open market. The holder of these bills is able to dispose of them in any money center which offers the lowest rate, and so the cost of financing the entire enterprise may be materially lowered. The owner of bills drawn under an authority does not possess this freedom of action, since the drafts are made not on a bank but on a merchant. Therefore, it is as a rule quite impossible to find a buyer outside of the bank advising the authority and so these bills are carried by the Far Eastern bank. Because these limitations are more or less variable, the charge for trade bill made under authorities must necessarily be fixed in this document. This rate rose as high as 9 per cent, but after the middle of 1921 the maximum was reduced to 8 per cent.

From the above observation it must be clear that the authority to purchase gives rise to a trade bill which has practically no market, and is therefore a non-liquid asset in the holding bank's portfolio. In general, the authority to purchase is an unsatisfactory instrument in financing foreign trade, and is gradually being superseded even in Far Eastern trade by the letter of credit.

## CHAPTER IX

### THE TRUST RECEIPT

**I. Meaning of the Trust Receipt.**—In financing an export or an import transaction through a letter of credit or an authority to purchase, a bank, as indicated in previous chapters, bases its extension of credit not only on the personal responsibility of the parties but likewise on the security found in the merchandise itself. The bank usually assumes legal ownership of this property by holding warehouse receipts or bills of lading evidencing title to the goods. The documents, and in fact the goods themselves, thus serve as security for the loan which the bank has granted to the borrower. At some stage in the transaction it is necessary for the borrower to obtain possession of the goods in order to market them and the bank wishes to offer every assistance to the borrower in disposing of the goods in order to facilitate the ultimate payment of the loan. The bank is thus confronted with the problem of releasing the documents representing the merchandise and at the same time of retaining title to the property underlying its loan. The bank seeks to accomplish these two conflicting ends by having the borrower sign a document known as a "trust receipt." In this instrument the borrower acknowledges the receipt of certain goods which are surrendered to him for a specified purpose. Although the borrower obtains actual possession of the property, the legal title is still retained by the bank and this fact is definitely stated in the trust receipt. It thus becomes more than a mere receipt of the goods, for it is also a formal recognition of the bank's ownership of the goods. In fact, a trust receipt has little or no value at law and cannot properly be used by a bank in any transaction where the borrower at any stage has had legal title to the goods. The trust receipt regards the borrower as agent and the bank as principal without disturbing the additional relationship of debtor and creditor between these two parties arising from the loan extended to the former by the latter (see form 14).

**II. Use of the Trust Receipt.**—The trust receipt is used by

a bank when it surrenders control over property which is serving as collateral for a loan. Large city banks granting call loans to brokers who pledge stocks and bonds find it necessary in the course of the daily business to return these securities to the borrowers for the purpose of enabling them to make sales. To guard against possible losses, the banks usually require the brokers to sign instruments which are called trust receipts. In a similar manner these instruments are also used by banks when they relinquish their control over cotton, grain, and other commodities which have been pledged as collateral for loans. Detailed consideration of the use of the trust receipt will be confined to the financing of transactions in foreign trade in which field the trust receipt has its widest and truest application.

1. *Exchange of Documents.*—The use of the trust receipt in facilitating the exportation of goods may be illustrated by tracing the course of a shipment of cotton. An Atlanta bank has extended a loan to a merchant on a warehouse receipt evidencing a certain number of bales of cotton stored in a local warehouse. The merchant sells the cotton to a Liverpool concern and in order to move the goods it is necessary for the seller first to have the warehouse receipts which the lending bank holds in its files. The bank obtains a trust receipt from its customer and gives him the warehouse receipts. The cotton is then withdrawn from the warehouse and placed on freight cars for transportation to the seaboard. The borrower thus has temporary possession of the goods but the bank usually limits this period of time to only a few days and requires the immediate delivery of the railroad bills of lading. The trust receipt thus facilitates the movement of the goods to market by replacing warehouse receipts with bills of lading. A further exchange of documents is necessary when the goods arrive at the seaport. Here the trust receipt is again employed, for the Atlanta Bank usually forwards the railroad bills of lading to its New York correspondent which releases these documents so that the forwarding agent may transfer the goods from the railroad to the steamer. When this is done the ocean bills of lading are tendered to the bank which then cancels the second trust receipt.

2. *Storage in Warehouse.*—While the exchange of documents is the sole use of the trust receipt in export transactions, the instrument has a wider employment in import dealings where it

is used for the following purposes: storage of goods in a warehouse, sale to known or unknown purchaser, conversion into manufactured form. Assume that a San Francisco Bank has issued its letter of credit to finance an importation of silk from Japan. The seller places the goods on board a vessel bound for America and his bank forwards the drafts with the accompanying documents to its correspondent in San Francisco for presentation to the bank which has opened the credit. These papers are usually sent by a mail steamer and so normally arrive before the merchandise itself. The drawee bank, on accepting the drafts, receives the documents. They are released on a trust receipt to the importer in order that he may be prepared to enter the goods at the custom house as quickly as possible on their arrival.

Whether the documents are given to the importer before or after the entry of the goods, the next step is to place them in a warehouse. If there is any doubt concerning the credit standing of the importer, the bank may retain the documents and itself warehouse the goods in its own name. But this task is usually performed by the importer who on signing a trust receipt is given the shipping documents representing the goods and warehouses them in his own name.

The importer is not always free in choosing the warehouse for the goods, as the bank may determine this selection. Since the lending bank is still the real owner of the goods, it will insist upon storage in a reliable warehouse. The bank is usually satisfied with the selection of a warehouse if conducted in compliance with the provisions of the Warehouse Act of 1916, which has tended to standardize the conditions for storing staple commodities.

The bank must also be certain that the warehouse is not controlled by the borrower. If such connection exists, the security of the bank's loan might become impaired, for the borrower would have free access to the goods, even though he did not possess the documents. Let us trace the consequences arising from a situation where a bank has not taken the proper precaution of ascertaining the relation between warehouse and borrower. Assuming that he has obtained possession of the goods on a trust receipt and has stored them with a company under his control, he is in a position to sell the goods and obtain the proceeds

fraudulently without holding the documents. If he goes into bankruptcy the bank is then confronted with the difficult task of recovering its claims. It is highly probable that these claims would not be regarded as superior to those of general creditors of the borrower and so the bank would be compelled to bear a proportionate loss. This eventuality is recognized in the ruling of the Federal Reserve Board which classes an acceptance as an unsecured loan if based on goods stored in a warehouse controlled by the borrower. The ruling in full reads as follows:

"If an acceptance is secured by shipping documents which are surrendered by the acceptor for a trust receipt which permits the purchaser of the goods to retain control of the goods, the accepting bank can not be said to be secured 'by some other actual security,' as provided in Section 13 of the Federal Reserve Act. A trust receipt, however, which does not permit the purchaser to procure control of the goods, may properly be said to be actual security within the meaning of the act.

The attached correspondence raises the question whether a national bank may accept drafts in excess of 10 per cent of its capital and surplus in a case where it appears that, though shipping documents are attached at the time of acceptance, those documents are thereafter delivered to the purchaser under a trust receipt, the goods being taken up at once by milling concerns.

Section 13 provides that no member bank shall accept for any one person, company, firm, or corporation in excess of 10 per cent of its paid-up and unimpaired capital and surplus, unless the bank is secured 'either by attached documents or by some actual security growing out of the same transaction as the acceptance.'

The question to be determined, therefore, is whether a trust receipt is an 'actual security' in the sense contemplated by the act. This question has been considered before by the Federal Reserve Board, and it has been generally understood that a trust receipt which permits the purchaser of the goods to obtain control of those goods either for milling or other purposes is not an actual security within the meaning of the act, and that, therefore, 'acceptances secured by such trust receipts come within the 10 per cent limitation imposed by Section 13.

A different situation results, of course, in any case where the trust receipt is of such a character as not to permit the purchaser to gain control of the goods as where they are held for the account of the acceptor by some person, warehouse, or corporation independent of the borrower.

It is the opinion of this office that in the case presented in the at-

tached correspondence where the documents are delivered to the purchaser, and where the goods are subject to his disposition, the trust receipt is not an actual security within the meaning of Section 13 and the 10 per cent limitation must be held to apply." (*Federal Reserve Bulletin*, vol. iii, p. 880.)

Because of unfortunate experiences in the past, a number of banks are no longer satisfied with the mere knowledge that the warehouse is uncontrolled by the borrower, but furthermore go to the extent of designating a specific warehouse in which the goods must be stored. In fact, a New York bank which is interested in the financing of cotton operates a subsidiary chain of warehouses and so has absolute control over the commodities underlying such loans.

It is good practice to record a detailed description of the merchandise on the trust receipt. The grade of the cotton, special marks on leather, the numbers on the packages, all serve as a means of identification. An auditor or other representative of the bank may use these notations in making a periodic inventory of the goods wherever they may be located. Regular examinations are most essential in checking commodities which are serving as collateral for loans.

A bank must see that the goods are fully insured against fire and the other losses and that it is named as beneficiary in the policy or certificate. At times these documents are made payable to the importer, but in such cases the bank is further covered by a rider which recognizes that the bank's interest in the destroyed property must be settled before the claims of any other parties.

When the goods have thus been stored in an acceptable warehouse, and insured by a reputable company, the warehouse receipts and insurance policies are returned to the bank, which then cancels the trust receipt.

3. *Sale to Purchasers.*—The policy of surrendering goods to a buyer is determined largely by the credit standing of the importer who is now the seller. Ordinarily the bank is not interested in knowing the name of the buyer, since it relies primarily upon the standing of the seller. But there are certain conditions under which the bank must exercise caution in surrendering its control over the goods. The importer may have only a limited

credit standing, or a line of credit extended by the bank may be nearly exhausted through drafts accepted in his behalf and other debits to his account. The bank may thereupon follow a conservative policy by itself making all the arrangements for delivering the goods from the warehouse to the buyers whenever the importer is able to effect sales.

Banks are not desirous of entering into the business of merchandising or of consignment finance, and so it is customary to surrender the goods directly to the importer on his trust receipt. This instrument does not always give the merchant complete freedom in selling his goods, for the bank may require him to submit the name of the prospective purchaser for approval. As the borrower's financial interest in the goods is usually less than the bank's, it is directly concerned in preventing sales at prices insufficient to cover the loan. The trust receipt may require not alone the name of the purchaser but also the selling price of goods. Some banks prevent sacrifice sales by simply inserting in their trust receipts the provision that the goods shall not be sold at less than the current market price. The bank may itself sell the goods directly or permit the importer to dispose of them to a specified purchaser. In most cases, the bank has assured itself of the importer's credit standing before issuing the letter of credit and does not care to approve of the persons buying the goods.

After the goods have been warehoused and later sold, the bank must determine what policy it will follow regarding the disposition of the proceeds derived from the sale. It must be remembered that the bank, on behalf of the importer, has accepted the drafts drawn by the exporter and is therefore obligated to pay these bills at their maturity. The bank does not actually pay these bills out of its own resources, but instead is placed in funds by the importer at some time in advance of the maturity of the bills. These anticipatory payments, or as they are sometimes called prepayments, must be made by the importer whenever the bank calls for them. Banks usually permit customers in good standing to withhold these prepayments until a time immediately preceding the payment of the drafts. In the case of a borrower with more or less doubtful credit standing, the bank may insist upon the prompt delivery of proceeds whenever goods are sold. In this way the customer's

liability is reduced gradually and is extinguished completely before the maturity of the drafts. By thus compelling the amortizing of loans, the bank gains a decided advantage in demanding prepayments. Under this plan the borrower is actually paying off a loan in part before it is due and he loses the use of this money, or its value expressed in terms of interest, in the period between the making of payment and the maturity of the obligation. Banks often allow a rebate of interest on the unexpired time of their acceptances to customers making anticipatory payments. The interest thus allowed may simply be a flat rate, say of 4 per cent, for all transactions. Banks which engage extensively in foreign trade graduate their rates according to the unexpired maturity of the acceptances and the prevailing cost of money. In a general way, the rate of interest will vary directly with the period of time between the prepayment and the maturity of the draft and usually no rebate is granted when the period of the bill has less than ten days to run. In granting allowances to their customers, banks may determine the cost of money in various ways. The rate may be fixed at from 1 to 2 per cent below the rediscount rate of the Federal Reserve Bank in case of dollar acceptances or below the rate of the Bank of England in the case of sterling bills. The ruling rate for prime bankers' bills of exchange may also serve as a basis for determining the rate to be allowed on prepayments. A third method is to grant customers the same rate that they would receive on demand deposits with the bank.

The subject of anticipatory payments applies only to selling of goods for cash. If the proceeds are in the form of notes or bills receivable, they are not regarded by the bank as prepayments until they are actually paid by the makers or drawers who have purchased the goods. If the bank so wishes, it may sell or discount these obligations in order to raise funds. Sales are also made on the open account basis, and so payment is deferred for 30 days or longer, depending upon the terms of sale. In this event the bank may compel the importer to indicate on his books that these accounts are assigned to the bank and later to tender the checks when payment is made by the purchasers of the goods.

4. *Conversion into Manufactured Form.*—Raw materials are also imported for the purpose of manufacturing them into fin-

ished products as in the case of hides to leather or hemp into rope. This situation presents an added complication to the banks, for the raw materials are converted into a different form and so identification of the bank's specific property may often prove difficult. It has occasionally been possible in the bankruptcy of the importer for a bank to reclaim its property by tracing identification marks, such as tags attached to leather. In order to avoid loss on loans collateralized by goods which are being manufactured, the borrower may be required to substitute goods of equal value for those originally covered under the trust receipt and later withdrawn for manufacture. Another way of maintaining the security of the bank is to replace the raw materials with goods in finished form.

**III. Protective Clauses in Trust Receipts.**—The above description of the various uses of the trust receipt has indicated the methods followed by banks to safeguard their interest in goods on which advances have been made. These protective measures find expression in the trust receipt forms issued by the banks. Some of these clauses are presented below:

1. *Selection of Warehouse.*—"For the sole purpose of obtaining said property and storing the same in a warehouse of the Y Company or other warehouse acceptable to the X Bank and to hand the storage receipt for the same properly indorsed forthwith to the said X Bank."

2. *Warehousing of Goods in Name of Bank.*—"Storing the same in the name as the property of the said bank and subject only to their order, we hereby agree to so store the said property and to hand the storage receipt for the same to the said bank, when obtained."

3. *Approval of Purchaser and Price.*—"In trust to deliver the same to ..... who have purchased the same for ..... payable in ..... and to obtain from the purchaser the proceeds of the sale of the same."

4. *Delivery of Proceeds of Sale.*—"In consideration of the delivery of said goods to us in trust as above, we agree to deliver them immediately to the said purchasers and to collect the proceeds of sale, and immediately deliver such proceeds to the X Bank, in whatever form collected, to be applied by them against the acceptances of ..... on our account, under the terms of Letter of Credit No. .... issued for our account, and to the payment of any other indebtedness of ours to ....."

5. *Substitution of Goods Manufactured.*—"It is further understood and agreed that the undersigned may at any time, with the approval

of said bank, substitute other goods of equal value in place of those originally covered by this agreement, and the rights of the said bank in regard to the goods so substituted shall be the same in every respect as if such substitution had not been made."

6. *Segregation of Bank's Property*.—"We agree to keep said goods, the manufactured product, and the proceeds thereof, whether in the form of moneys or accounts and bills receivable, separate and capable of identification as the property of the X Bank."

7. *Entries on Books of Borrower*.—"The undersigned, in further assurance, agree that in so far as the undersigned, such entries shall definitely indicate that said goods and documents and said proceeds thereof are the property of said bank."

8. *Insurance Payable to Bank*.—"The said goods and the manufactured product thereof while in our hands shall be fully insured against loss by fire, and the insurance money received for any loss shall be subject to the trust hereon contained in the same manner as the goods themselves."

9. *Prohibition on Rehypothecation of Goods*.—"We promise that neither the merchandise nor the proceeds thereof, covered by this trust receipt, shall be pledged or hypothecated in any manner, and that it shall be kept free from all liens except that covered by this present trust receipt."

10. *Recognition of Ownership*.—"We recognize and admit the ownership of the immediate possession of the described property of the X bank and its right and the right of its agents in and to the relative documents therefor, and until such delivery to the bank of the above required documents."

11. *Right of Immediate Repossession*.—"All the obligations and other terms of the said agreement are made a part hereof and reaffirmed, and the said bank shall be and remain owner of the said merchandise and the proceeds thereof, with the full rights pertaining to such ownership, including the right at any time to take possession of the said merchandise and proceeds wherever found, and to collect the proceeds of sale."

The enforcement of the above precautionary clauses by banks would undoubtedly reduce losses arising from loans on trust receipts. Unfortunately these measures have not been generally applied by banks. There was little careful supervision and check in the busy years since 1915 when the enormous financing of exports and imports taxed the working force of American banks beyond their capacity. Besides, there was little need for concern over loans based on commodities, as their ever-soaring market price seemed to offer adequate cover, but with the pre-

cipitous fall in the price level beginning with the spring of 1920, banks encountered trouble with customers to whom goods had been released on trust receipts. These borrowers found difficulty in disposing of their goods, and when sales were actually effected, the cash proceeds were retained in order to stave off insolvency. Borrowers in desperate straits obtained additional loans by rehypothecating their goods with other banks. These institutions found themselves without control over the goods which were their property. Where the form had been changed by manufacture, it was practically impossible to trace the original material.

**IV. Legal Aspects.**—The general unsettled status of the trust receipt in commercial usage is further accentuated by the uncertainty of this instrument at law. It has been the subject of litigation in state and federal courts on many occasions. The courts have usually sustained the rights of the banker to property under a trust receipt against a customer who has received a loan, but there is little unanimity concerning the claims of the banker against third parties who as bona fide purchasers have come into possession of the goods.

The rights of a bank under a trust receipt have been seriously limited in the recent case of *Irving National Bank vs Dernburg & Son*, reported in the *New York Law Journal* (Jan. 6, 1922), as follows:

"The Irving Bank, New York, had taken as collateral for a loan a certain negotiable warehouse receipt and thereafter, and while the loan was still partly unpaid, permitted the bankrupt company to repossess itself of certain fox skins included within the warehouse receipt, the bank obtaining a trust receipt in the usual form. These fox skins came into the possession of the receiver and the bank made a motion to obtain possession of the goods. This is the motion which Judge Knox denied, writing an opinion which reads in part as follows: 'If, as is said in *Lathrop vs Holland* (205 Fed. 143), a purpose of the bankruptcy acts and of state recording statutes is to discourage secret equities, this motion should be denied. In my opinion the only title to the skins which was acquired by petitioner is of no different character than that which would have been conveyed by a chattel mortgage. Having this security title, petitioner permitted bankrupt to repossess the skins and thus afford an opportunity for the deception of persons who might deal with the bankrupt upon his possession of the goods sought to be reclaimed.

I feel that petitioner is in no position to ask protection under the case of *in re Cattus* (183 Fed. 733). The doctrine there announced was specifically limited to trust receipts representing an advance of purchase money, and I am not disposed to follow that decision beyond the requirements of its facts. Should this contention of petitioner in the present instance be sustained, it would, in my humble judgment, serve to uphold a practice which I believe to be grossly inequitable as against general creditors, and which would lead to great abuse. The motion is denied.' ”

The confusion in applying legal remedies to cases arising from the trust receipt is due largely to the fact that as yet no satisfactory legal classification has been evolved by judicial interpretation.<sup>1</sup> On this subject Dr. Harlan Stone, Dean of the Columbia Law School, writing in the *Columbia Law Review* (May, 1915, vol. 15, p. 433), made the following observations:

“The courts are at a loss to determine under which of the recognized classes of security arrangements trust receipts shall be grouped. It is important to note as a starting point that, in nearly every case, the agreement reserves the legal title to the goods in the banker until the importer repays his advances, and the courts are unanimous in recognizing this legal title and in protecting it. Since, therefore, the bank is the legal owner, it cannot be a *cestui que trust*, a pledgee, or a legal or equitable lienor. The idea of a pledge or lien is still further negatived by the fact that the bank retains its security after parting with possession of the goods. The transaction is unlike a factor's agreement in that the factor simply remits to his principal a certain percentage of the proceeds from his sales, whereas the importer is bound to pay the fixed purchase price which was advanced by the bank, regardless of what he realizes from the goods. This process of elimination leaves conditional sales and chattel mortgages as the only forms of security to which a trust receipt agreement is similar, but the authorities are in conflict as to which of these transactions it is most like. If it be a chattel mortgage, it must be recorded to be valid against the creditors of the importer, and this is also true of conditional sales in many states. Again, were it placed under either of those categories, the fact that the debtor is permitted to sell and deal with the property as his own would, in most jurisdictions, estop the banker from asserting his title in the event of the importer's insolvency. And yet the courts have not only

<sup>1</sup> See article in *Columbia Law Review*, May, 1922, vol. 22, No. 5, pp. 395-420.

refused to apply the Recording Acts to these transactions, but have also upheld the banker's rights against parties claiming under the importer as judgment or attaching creditors, lienors, trustees in bankruptcy, pledgees, and even an innocent purchaser for value of the importer's claims against purchasers of the goods. These decisions may rest on a distinction which the courts have adopted with reference to other consignment arrangements, which is that if the debtor is permitted to sell the goods and treat the proceeds as his own, the retention of title by the creditor is a fraud; but if the agreement that the debtor can sell require him to apply the proceeds in diminution of the debt secured by the goods, the creditor's title will be recognized. Or the cases may rest on the broader ground that since trust receipt agreements are well recognized in business circles as legitimate and necessary to commerce, the courts will always strive to protect the banker's title. But whatever may be the reason, the fact remains that the courts refuse to subject such agreements to the disabilities which are imposed upon conditional sales and chattel mortgages, a fact which seems to indicate that those courts are correct which distinguish them from either. Other questions arise apart from the validity of the bank's title against claimants under the importer. In the recent case of *Brown vs Massachusetts Hide Corporation* (C. C. A. 1915) 218 Fed. 769, the trust receipt stipulated that the importer should hold the goods and their proceeds as security not only for the payment of the debt for those particular goods, but also for 'any other indebtedness.' Upon the appointment of a receiver for the importer, the bank claimed that some goods which the importer had already paid for should be treated as security for other debts not yet due. The District Court disallowed this claim, following the *New Haven Wire Company* cases, which hold that the transaction is a conditional sale and that, therefore, as soon as the importer pays for the goods and all debts then due, title passes free from any lien for other debts. The circuit Court of Appeals, however, rejected this doctrine and upheld the bank's contention. This decision is in harmony with the leading case of *Charavay vs York Silk Mfg. Co.*, in which also the court feels bound to repudiate any idea of conditional sale in order to permit the bank to reclaim and sell the property and then recover from the importer any deficiency between the amount realized on the sale and the amount advanced to the importer. As a matter of principle, it is submitted that here, as in the cases involving the validity of trust receipts, the same results can be reached whether we call the transaction a conditional sale or a mortgage. Since the retention of title by a conditional vendor is merely to have security for the purchase price, the transaction is in its essence a mortgage. This is evidenced by the fact that the risk of loss of the goods is not on the seller, despite his legal title, but is on the buyer. It follows that since a mortgage is per-

mitted to foreclose and sell the property and then recover any deficiency from the mortgagor, a conditional vendor should have a similar right. The court in the Charavay case seems to fear that if a conditional vendor retakes the goods he thereby destroys the consideration for the debtor's obligation to pay and consequently cannot thereafter maintain an action for the deficiency. But this difficulty is avoided if the vendor reclaim the property, not as his own, but expressly for the purpose of reselling on account of the buyer. And finally it is only a logical extension of this analogy to permit the conditional vendor's title to stand as security, not only for the purchase price of those particular goods, but also for other debts as well if the parties so stipulate. In such a case, the bank might be the legal owner of the goods until they were paid for, and might thereafter have an equitable lien on them for other debts."

State courts have classified a trust receipt variously as a secret lien, chattel mortgage or conditional sale. In several states the trust receipt has been regarded as a form of chattel mortgage or conditional sale, and so is governed by the provisions of the recording statutes. It is then necessary for the banker to record the terms of the trust receipt and file in the local record office an affidavit which reads somewhat as follows:

"State of .....,  
..... County, ss:

....., being first duly sworn, on his oath deposes and says that he is ..... of the X Bank, the corporation named and referred to as the bank in the trust receipt, copy of which is attached: that attached hereto marked "Exhibit A" is a true, correct, and exact copy of a certain trust receipt executed by ..... under date of ..... 19.... in favor of said X Bank in the sum of ..... Dollars (\$.....), ..... together with interest thereon at the rate of ..... per cent (..%) from the ..... day of ..... 19..; that said claim is just and unpaid, and that to secure the payment of the same the within trust receipt has been executed and delivered to said bank in good faith.

Sworn to before me and subscribed in my presence by the said ..... this day of ....., A. D. 19...

Notary Public."

Most trust receipts arise from bankruptcy proceedings, but the federal courts have never attempted to classify it. However,

its legality has usually been sustained on the basis of its necessity as a useful commercial instrument. As observed in the *Cornell Review* (January, 1921, vol. 6, No. 2, pp. 168-178) this view of the federal judiciary has had the same effect as a legislative enactment establishing the validity of the trust receipt. Several of the states have actually written this theory on the statute books by passing laws which give the banker a measure of protection under loans based on trust receipts. The law of Louisiana on this subject reads as follows:

(Act No. 9 of 1914 Laws of Louisiana.)

An act making it a felony to withdraw collateral pledged to a bank on a trust, or other form of receipt, and when so withdrawn, to use, sell, repledge or otherwise dispose of same for any other purpose than that of paying the indebtedness; or to fail or refuse to return collateral so withdrawn on a trust, or other form of receipt, on demand, or in lieu thereof to make to the pledges a cash payment equivalent to the full value of said collateral; or should said collateral exceed in value the indebtedness it secures, to fail or refuse to make a cash payment to the pledgee equal to the full amount of said indebtedness; making the proof of certain facts prima facie evidence of criminal intent, but giving the state the right to prove intent in addition thereto by any competent evidence; dispensing the State from the necessity of proving that a person when acting in a representative capacity so withdrawing said collateral and using same unlawfully, derived any personal benefit or profit from said transaction; providing penalties for the violation thereof and repealing all laws or parts of laws, contrary to or inconsistent herewith; provided, however, that nothing in this act shall be taken or intended to affect any prosecution which was pending in any court at the date of the passage of this act.

Section 1. Be it enacted by the General Assembly of the State of Louisiana, That any person that is a customer or any person being an officer, member, agent, or employee of any person, partnership or corporation that is a customer of any bank or banking institution, savings bank, or trust company, organized under the laws of this State, of the United States or of any foreign country, or of a private banker, or of a person, firm, or corporation that loans money on collateral security, doing business in this State, who is allowed to withdraw any collateral pledged by him, personally or in his representative capacity, on a trust or other form of receipt and, first, who uses, sells, repledges or otherwise disposes of said collateral so withdrawn, for any other purpose than that of paying the indebtedness for the security of which the said collateral

was pledged; or, second, who fails or refuses to return said collateral on demand, or who fails or refuses in lieu of the return of said collateral to make to the pledgee a cash payment equivalent to the full value of said collateral so withdrawn, or should said collateral exceed in value the indebtedness it secures, who fails or refuses to make a cash payment to said pledgee equal to the full amount of said indebtedness, shall be guilty of a felony.

Section 2. Be it further enacted, etc., That proof of any of the acts set forth in section one of this act shall be considered *prima facie* evidence of criminal intent; provided, however, that the State shall have the right to proceed further, if it so elects, and prove such criminal intent by any competent evidence in its possession.

Section 3. Be it further enacted, etc., That in all cases where the person doing the things denounced by this act was an officer, member, agent, or employee of any person, partnership, or corporation, that was the customer of the bank, or person, firm, or corporation loaning money on collateral security, it shall not be necessary to complete the proof of crime charged, for the State to prove that such person derived any personal benefit, advantage, or profit from such transaction; provided, however, the State shall always have the right to make such proof by any competent evidence it may have in its possession.

Section 4. Be it further enacted, etc., That any person violating any of the provisions of this law shall be deemed guilty of felony, and, on conviction, shall be imprisoned with or without hard labor for not more than ten years, in the discretion of the court.

Section 5. Be it further enacted, etc., That all laws or parts of laws contrary to or inconsistent herewith are hereby repealed; provided, however, that nothing herein shall be taken or intended to affect any prosecution which was pending in any court at the date of the passage of this act under the provisions of Act 120 of 1910.

The general laws of Maryland (article 27, section 119) contain the following statute, shorter in form than the Louisiana act but quite similar in content:

"If any person or persons shall on his or their own behalf, or shall for or on behalf of any other person or persons, or shall for or on behalf of any firm, copartnership, or corporation, receive, accept, or take in trust from any person, persons, firm, copartnership, or corporation any warehouse receipt or bill of lading or any document giving or purporting to give title to or right to possession of any goods, wares, merchandise, or other personal property of any kind, under

or subject to any written contract or agreement expressing the terms and conditions of such trust; and if such person or persons so receiving any warehouse receipt or elevator receipt, bill of lading, or any document giving or purporting to give title or the right to possession of any goods, wares, or merchandise or other personal property of any kind shall, in violation of good faith, fail, neglect, or refuse to perform or fulfill the terms and conditions of such trust as expressed in such written contract or agreement, then, and in every such case, such person or persons so failing, neglecting, or refusing to perform or fulfill the terms and conditions of such trust shall, on being convicted thereof, be imprisoned in the penitentiary for a term of not more than ten years nor less than one year, or be fined not more than five thousand dollars (\$5,000) nor less than five hundred dollars (\$500), or both, in the discretion of the court."

**V. Bailee Receipt.**—As previously mentioned, the trust receipt has often failed the banks in pressing their claims against third parties who have purchased the goods from the borrower. In thus releasing goods for the purpose of sale, banks at times require customers of doubtful standing to sign a form known as a bailee receipt. This document is developed from the term "bailment" and is regarded as more stringent than the trust receipt and is supposed to offer the bank more adequate protection. The opinion has also been expressed that any trust receipt is *a priore* a bailee receipt, and so no legal distinction exists between these two instruments. A typical bailee receipt reads as follows:

Received from the X Bank, solely for the purpose of selling the same for account of said bank, the following property, marked and numbered as follows: .....  
 .....  
 and ..... hereby undertake to sell said property for account of said bank and collect the proceeds thereof and deliver the same immediately upon receipt to the said bank in whatever form collected, to be applied to the credit of ..... hereby acknowledging ..... to be bailee of said property for the said bank, and ..... do hereby assign and transfer to the said bank the accounts of the purchasers of said property to the extent of the purchase price thereof, of which fact notice shall be given at the time of delivery of said property by ..... to said purchaser or purchasers and all invoices therefor shall have printed, written, or stamped thereon the following: "Transferred and payable to the X Bank."

If said property is not sold and the proceeds so deposited within 10 days from this date, ..... undertake to return all documents at once upon demand or to pay the value of the goods at the bank's option.

The said goods while in our hands shall be fully insured against loss by fire for the benefit of the bank.

The terms of this receipt and agreement shall continue and apply to the merchandise above referred to, whether or not control of the same or any part thereto be at any time restored to the X Bank and subsequently delivered to us.

In actual practice, little distinction is drawn between the two documents and in fact both share the same weaknesses.

**VI. Value of the Trust Receipt.**—Due to the irregularities which have been developed in the practical handling of the trust receipt, and the uncertainties which have continued in the legal interpretation of the instrument, its use has declined. Banks have come to regard it as a mere receipt for goods surrendered to the borrower and the opinion is quite general that the title of the bank to property thus released is not given adequate protection under the ordinary trust receipt. As a result a loan based on goods released under a trust receipt in most cases is regarded as an unsecured obligation of the borrower who thus receives this advance merely on the strength of his credit standing.

According to this view a borrower's note based on a trust receipt is worth little more than a straight single name paper. The general acceptance of this view by banks would naturally limit the use of the trust receipt and confine its application only to individuals and firms of recognized credit standing. The adoption of this policy would impose a serious disability upon small borrowers whose credit is not well known. To prevent the trust receipt from thus falling into disrepute and to raise it to somewhat the same level as other documents of title, such as the warehouse receipt and the bill of lading which today afford the banker ample assurance of security for his loans, several recommendations may be offered.

**1. Insistence upon Observance of Terms of Trust Receipt.**—There is unquestionably a need for closer observance of the terms of the trust receipt on the part of borrowers. It is common knowledge that the provisions of the trust receipt are not re-

spected by borrowers. Noncompliance with the conditions of the trust receipt has been further encouraged by the absolute inability of banks to obtain the conviction of customers who have committed flagrant violations.

The breaches by the borrowers to some extent can be charged to the policies of the banks themselves. They have in the past been influenced by the desire to secure new business and have therefore hesitated to call the attention of their customers to the obligation assumed under the trust receipt. Banks have been unwilling to force their customers to surrender the proceeds derived from the sale of goods for fear that this policy would result in the transfer of the account to another institution which followed a more liberal policy in allowing say 30 days of grace.

2. *Protective Measures to Control Property.*—Losses which banks have sustained on trust receipt are of course due primarily to misjudging credit risk of the borrowers, but such losses to a large extent can be overcome by the use of some of the clauses outlined above.

3. *Judicial Recognition of the Rights of Lenders under Trust Receipts.*—The confusion of state courts on the controversial aspects of the trust receipt is due fundamentally to the absence of an agreement as to the correct legal classification of the instrument. The solution lies in the general adoption of the view accepted by the federal courts that the trust receipt is an essential instrument in commercial usage. As noted in the *Cornell Law Review* this rule in preserving the rights of the banker must be limited in its application so as not to interfere with the claims of third parties who have come into possession of property as bona fide purchasers for value.

4. *A Uniform Statute Governing Trust Receipts.*—This statute could be adopted by the states in the same manner as the Uniform Negotiable Instruments Law. The trust receipt could also be the subject of federal legislation similar in form to the bill of lading and the U. S. Warehouse Receipt Act. The constitutionality of a federal act on warehouse receipts would probably be sustained on the ground that the legal consequences arising from the instrument affect directly the operation of the bankruptcy laws as applied in the United States courts.

## CHAPTER X

### BRITISH COMMERCIAL CREDITS

In analyzing the various phases of commercial credits as used in foreign trade, consideration has thus far been confined almost entirely to the forms and practices of American banks and the decisions of American courts. This chapter will present the subject of British credits. As the technique of American and British banks in issuing letters of credit is in many respects the same, it is unnecessary to repeat the detailed description given in the preceding chapters, and so the discussion will be limited to only those characteristics peculiar to British practice. The subjects will be treated in about the same order as followed in the above chapters, and so consideration will be given to the commercial letter of credit, traveler's letter of credit, and trust receipt. In Chap. X attention will be directed to the decisions of the British courts, which for over half a century have adjudicated disputed issues among merchants and bankers concerning commercial letters of credit. The supremacy of the sterling credit in international trade is, to some extent, based upon the firm legal foundation established by the courts of Great Britain and her colonies.

**I. Classification of Commercial Letters of Credit.**—British letters of credit may be classified according to the same principles which were applied in Chap. III in grouping American letters.

1. *Security.*—On the basis of security, credits may be either clean or documentary. The clean letter of credit permits the drawing of drafts unaccompanied by documents of any sort. This unconditional form is often called an "open" credit and its duration is usually limited by British banks to 6 months. While the term "documentary" is generally used by English banks in referring to credits which require the beneficiary to present bills of lading, insurance policies, and invoices, the expression is also applied to the instrument which has been described above as an "authority to purchase" (see Spalding, "Bankers' Credits," p. 75).

2. *Tenor*.—British banks handle both cash and acceptance credits. (*Journal of the British Institute of Bankers*, vol. 35, p. 131.) In fact, a time draft drawn under a letter of credit issued by a London bank was, until 1914, the standard instrument in overseas finance.

3. *Renewal*.—Revolving credits have long been familiar to English business men as is evidenced by court decisions of the past fifty years.

4. *Currency*.—Although British banks possess the necessary correspondent facilities for opening credits in dollars, francs, marks or any foreign currency, the majority of their letters have called for the drawing of drafts in sterling. This has been due partly to the confidence of merchants all over the world in the strength of the London money market, but it has also been attributable largely to the policy of British banks in encouraging the use of sterling over other currencies.

5. *Transferability*.—While most letters of credit can be used only by the beneficiary, British banks also issue a considerable number of credits which are transferable. These usually contain the expression, "We hereby authorize you or your assigns in writing to draw upon us."

6. *Negotiation*.—A beneficiary may hold a letter which permits him to negotiate his drafts only with the bank notifying him of the credit which is then described as a "special credit." Letters of credit usually contain a promise by the issuing bank to all holders of bills drawn by the beneficiary that they will be duly honored upon presentation. The accredited party is thus able to sell his drafts to the bank offering the most favorable rate of exchange and the credit is said to be general or "open" in form.

7. *Location*.—Domestic letters of credit are relatively unimportant, since the internal commerce of England forms only a small portion of its total trade.

8. *Number*.—British letters may be either original or ancillary, as in the case of American forms (see p. 32).

9. *Direction*.—To cover the financing of exports "outward" credits are opened, and for imports the credits are said to be "inward" in form.

10. *Method of Financing*.—With the establishment of the gold standard in 1816, the pound sterling became practically a

receipt for a specified amount of gold. Sterling was everywhere favored by sellers in preference even to the currency of their own country. Sterling credits were used to finance the movement of goods between ports other than those of Great Britain and thus a large proportion of British letters of credit were used in the indirect financing of foreign trade as well as the direct.

**II. Confirmed and Unconfirmed Credits.**—The fundamental basis for the classification of credit letters rests upon the question of their revocability. For the present this subject will be considered from the viewpoint of commercial usage, while a presentation of the legal aspect will be deferred until the following chapter.

For many years no sharp distinction was drawn by British bankers between irrevocable and revocable credits. In a general way it was held that a letter of credit could be canceled by an issuing bank but only under exceptional circumstances. As late as 1914 the *Journal of the British Institute of Bankers* discussed the conditions which would justify a bank in canceling its "confirmed" letter of credit, and the article in conclusion believed it "undesirable that a bank which has granted a confirmed letter of credit should revoke it without very strong reasons for such a step" (January, 1914, p. 74). From this excerpt it is interesting to note that the *Journal* at first did not view the confirmed letter of credit as an obligation binding absolutely upon the issuing bank. Several years later the same periodical definitely states that a "confirmed credit can only be canceled with the agreement of all parties thereto," while an unconfirmed credit is described as one which "can be canceled by the buyer or even by the bank concerned under exceptional circumstances." (January, 1916, p. 10; February, 1920, p. 54).

British banks usually regard the terms "confirmed" and "irrevocable" as practically synonymous in the sense that both expressions apply to credits which may not be canceled without the consent of the beneficiary. Some banks recognize the distinction between a confirmed and an irrevocable credit as explained before on page 29.

The wording in the address to the beneficiary is about the same in British letters as in the American forms. The communication usually begins by addressing the accredited party thus: "You are hereby authorized to value upon us." At times the

beneficiaries are addressed in the third person, as: "Messrs. ——— are hereby authorized to value on the X Bank." One joint-stock bank employs the following expression: "We hereby confirm that we will pay the sight drafts of ——— upon us."

Unconfirmed credits are regarded as being revocable by banks at will, as evidenced in the following expression found in the unconfirmed credit letter of a leading British bank:

"We have no authority from our clients to confirm this credit or to guarantee the payment of drafts drawn there against ———"

It must be understood that this letter is for your guidance only in preparing documents and conveys no engagement on the part of the bank, as we have no instructions to confirm the credit to you."

There is a wide difference of opinion as to whether an unconfirmed credit may be canceled without giving the beneficiary previous written notice. A number of banks in their unconfirmed letters expressly inform the beneficiary that "the credit is subject to cancellation *without notice*." Where an unconfirmed credit is advised by a bank through its branch or agency, the beneficiary's drafts must be honored if presented to the branch before it receives the order of cancellation.

Confirmed and unconfirmed credits differ in that the former always contain a definite expiration date, but this is not an essential characteristic of the unconfirmed form. The question often arises as to whether a credit expires at the office of the opening bank in London or of the advising agency abroad. As a rule, the latter is regarded as the exact place at which a credit terminates. On this subject Spalding in "Bankers' Credits" (p. 20) offers the following observations:

"Differences on this matter of cancellation sometimes arise between the banks issuing the credits and other banks through whom they are advised. Between the banks interested, the whole question seems to be dependent on the exact meaning of the phrase, 'the place in which the credit is opened.' The argument is that the issuing bank is only obliged to accept such bills as are drawn prior to the date on which notice of cancellation of the credit is received by the negotiating bank in the place in which the credit is opened. The question in dispute is: which is the place in which the credit is opened—is it in London or is it in the foreign city? Bankers through whom such credits are ad-

vised say the place in which the credit is opened is the city in which it is to be operated upon. Care should be taken, therefore, not to confuse the place from which the credit is advised with the place in which the credit is opened; and to avoid all ambiguity, the negotiating banker, or the intermediary through whom the advice is sent, can always safeguard himself by insisting that the credit states that it is to be opened in the foreign city. If this point is made clear, the dubiety about the exact date upon which the issuing banker's guarantee to accept ceases would be dispelled, at any rate, between him and the negotiating banker."

**III. Travelers' Letters of Credit.**—Travelers' letters of credit issued by British banks are similar in most respects to those emitted by American institutions. Several joint stock banks of London have entered into a coöperative arrangement whereby a traveler's letter of credit issued by any one institution is negotiable at any of the branches of all the participating banks. It is estimated that the letter of credit of any one of these London banks is cashable at nearly five thousand different offices, and the instrument is therefore justly described as a "world letter of credit." Its operation is about the same as the ordinary American letter of credit. The holder is authorized to draw upon the London office of the bank in the form of a sight draft, and the paying office enters the amount of the draft and the date of the drawing on the reverse side of the letter. The beneficiary is given a letter of indication on which he has signed his name and this signature is used as a means of identification.

**IV. Letters of Lien.**—British banks employ instruments known as letters of lien, or trust letters, which are about the same as American trust receipts. (Stead, "Bankers' Advances," p. 29.) These documents are used to protect the legal title of a bank to property which is serving as collateral for a loan but which at the same time is released to the borrower in order to enable him to effect a sale. A typical British letter of lien reads as follows:

London, ..... 19...

To the X Bank, Limited.

Gentlemen:

In consideration of your delivering to us the following documents,  
 viz.: ..... for .....  
 .....

worth £..... or thereabouts, the receipt of which we hereby acknowledge, we hereby engage to hold the said ..... and the goods represented thereby, and the net proceeds thereof, to your order, as your agents and in trust for you, and to hand you direct the proceeds of the sale thereof, as and when received, especially to ..... and for further security to you we also undertake to keep the said goods fully insured against fire and aircraft on your account, to hold the policies as trustees for you, and, in the event of loss, to hold and apply the full amount of the insurance money in like manner as proceeds of sale.

And we hereby acknowledge it to be our full understanding and agreement that we will not part with the said ..... or goods represented thereby, for any purpose whatever, except to the purchasers thereof, in accordance with the customary course of business, but will, as trustees for you, retain the entire control of them, except as aforesaid. We also undertake at any time on request to transfer the said ..... or goods represented thereby, or any policy of insurance relating thereto to you, or as you shall direct, in which event it is agreed that you shall immediately thereupon have an absolute power of sale over the said goods.

Yours faithfully,

.....

The position of the merchant-borrower is described in various ways in the letter of lien. He is at times regarded as the agent of the bank, and in certain forms he is considered simply as a broker of the lending institution. Practically all British letters of lien convey the thought that the customer is merely holding the merchandise as trustee of the bank.

In some respects, the letter of lien holds a stronger legal basis in England than the trust receipt has in the United States. Here the conflicting decisions of state courts have rendered the legal nature of the trust receipt very uncertain. On the other hand the letter of lien on England has been rather firmly established in several definite decisions, and misappropriation of the goods or proceeds is a criminal offense. Consideration may here be given to the case of *Hamilton Young & Co., ex parte, Carter*, (1905) 2 KB. 772. A certain exporting house conducted its business by purchasing goods, sending them to the bleachers and then shipping them to the Far East, mainly to Erving and Co., a Calcutta firm. These transactions were financed by a bank with which the exporting house carried a general and also a

loan account. As this firm was called upon to pay for its purchases, it drew checks upon the bank which in turn honored them. To collateral these advances, the lending bank received from the borrower a letter of lien which read in part as follows:

"We beg to advise having drawn a check on you for £. . . . ., which amount please place to the debit of our loan account, No. 2, as a loan on the security of goods in course of preparation for shipment to the East. As security for this advance we hold on your account and under lien to you the undermentioned goods in the hands of (here followed list of goods and names of bleachers) as per their receipt inclosed. These goods when ready will be shipped to Calcutta, and the bills of lading, duly indorsed, will be handed to you, and we then undertake to repay the above advance either in cash or from the proceeds of our drafts on Messrs. Erving & Co., Calcutta, to be negotiated by you and secured by the shipping documents representing the above mentioned goods. But in no case is the advance to extend beyond two months from date hereof, unless by special arrangement, at the expiration of which we undertake to repay the same or any portion thereof then outstanding. Interest on this advance to be at the rate of 6 per cent per annum. We undertake that the goods, while in course of preparation for shipment shall be covered against fire risk under a general policy of assurance which we shall deposit with you."

The bank learned that Erving & Co. was in difficulties, and thereupon instructed the bleachers to hold the goods at the bank's order. This was the first notice which the bleachers had received regarding the existence of the letter of lien or of the bank's interest in the goods. In court the debtor firm contended that the letter of lien was void, since it was a "bill of sale," and so required registration under section 4 of the Bills of Sale Act, (1878, 41 & 42 Vict. C 31). However, the court held that the Bills of Sale Act did not apply to letters of lien. "This document," said the court, "was used in ordinary course of business as proof of the control of goods. . . . It enabled the bank to prevent the bankrupts, by injunction, from dealing with the goods in any manner inconsistent with the arrangement." (1884 15 Cox, C. C. 466.) (See also *Allister vs Barclay Bank*, decided in Chancery Court, May 4, 1922.)

In addition to some of the American practices described in Chap. IX, British banks employ several other methods to safe-

guard their interest in goods released on trust receipts. British forms frequently state the value of the merchandise, percentage of margin, amount of the loan advanced to the customer, and date of maturity. British banks also make it a practice to inform warehousemen that certain merchandise in the custody of the latter is hypothecated and must not be delivered to anyone without orders from the banks.

**V. Legal Theories on Letters of Credit.**—An analysis of British cases on the letter of credit indicates that the courts in their effort to determine the legal nature of the instrument have at different times considered the possibility of regarding it as: (1) a negotiable instrument, (2) equitable assignment, (3) form of contract.

1. The theory which views the letter of credit as a negotiable instrument is rejected in *Orr and Barber vs Union Bank of Scotland* (1854), 1 Macq. 513; 24 L.T.O.S.; 1. Here it is decided that the holder of a letter of credit is not necessarily entitled to draw drafts. In connection with this case, it must be stated that the letter of credit involved was not of the modern commercial type but rather of the traveler's form. This letter of credit is partially recognized as a form of bill of exchange in Section 32 of the Stamp Act of 1891 which provides that the instrument must be stamped. The duty is waived in the case of drafts drawn outside of the United Kingdom, even though authorized under letters of credit issued within the United Kingdom (exemption 4, under Bill of Exchange).

2. The doctrine that the letter of credit is an equitable assignment of funds is well analyzed in *Morgan vs Larivière* (1875), L.R. 7 H. L. 523 (see later, p. 154). The theory is stated by the counsel for one of the litigants in these words:

"The letter written by the appellants [bankers] to the respondent [beneficiary] must be taken as an appropriation of a specific sum of money. The money must have been in the hands of the appellants, who were the financial agents of the French Government [openers of the credit], but whether that was the fact or not was really immaterial. They had stated the amount which they bound themselves to pay. This letter was written after the respondent had agreed to supply the goods, and was in fact a declaration that the appellants had the money to meet his demands for his goods, and that it would be paid to him on that account. It is called a special credit, but what is a special

credit except a declaration that there is in the hands of these persons a certain sum of money devoted to a particular purpose."

The court definitely repudiated this view and disposed of the theory of equitable assignment in an able opinion which is reproduced below:

"What is there in this letter which constitutes an equitable assignment, or what is there in it which impresses with a trust any particular sum of money? I can find no expression in this letter which could authorize such a conclusion. It appears to me to be simply a statement by a banker that he has opened a credit under instructions in favor of a particular person. That is an expression well known to bankers, and well known to all persons engaged in commerce. It is simply an undertaking by the person who conveys that intimation that he will give credit, that he will pay, that he will allow himself to be made a person upon whom demands or drafts may be made for payment. Your Lordships are perfectly familiar with this, which occurs every day in commerce: a credit is opened with a particular house of business in favor of another house of business; generally a credit of that kind is, to use a mercantile phrase, 'operated upon' by bills of exchange being drawn upon the house which undertakes to give the credit; but a credit of that kind may be operated upon also by means of cheques, or it may be operated upon by simple demands, in any form, for the payment of the sum for which credit has been undertaken to be given.

My Lords, I read this letter as being nothing more than this: A statement by bankers to a tradesman who supplies goods to a customer of the bankers' that they, the bankers, on behalf of their customer, will act as paymasters to the tradesman up to a certain amount of money; but that, in order to call upon them to act as paymasters, he, the tradesman, must bring with him a certain certificate showing that the goods have been delivered to their customer. In a transaction of that kind there is nothing of equitable assignment, there is nothing of trust; and it appears to me that any banker who had given an undertaking of that kind would be very much surprised to find that it was held that a certain portion of the funds of his customer in his hands had been impressed with a trust, had been equitably assigned, and had, in fact, ceased to be the moneys of the customer, and had become the moneys of the tradesman who was to supply the goods."

3. The thought that the letter of credit is a form of contract finds expression in many British decisions, one of which reads as follows:

“The letter is a general invitation issued by the Agra & Masterman’s Bank [issuer], through Dickson, Tatham & Co. [beneficiary], to all persons to whom the letter may be shown, to take bills drawn by Dickson, Tatham & Co. on the Agra & Masterman’s Bank with reference to the letter, and to alter their position by paying for such bills, and an assurance that, if they or any of them would do so, the Agra & Masterman’s Bank would accept such bills on presentation. Upon the offer in this letter being accepted, and acted on by the Asiatic Banking Corp. [negotiators], there was constituted a valid and binding legal contract against the Agra & Masterman’s Bank [issuer] in favor of the Asiatic Banking Corp.” (Re Agra & Masterman’s Bank [865], 36 L.J. Ch. 222.)

## CHAPTER XI

### THE LETTER OF CREDIT IN BRITISH LAW

In the same manner that American cases on letters of credit were presented in Chap. VII, consideration will now be given to leading British decisions. These are more numerous than American cases and, in general, are more important because they present a greater range of banking experience and of legal knowledge. In order to supplement the views of the British courts, occasional reference will also be made to the findings of the Colonial courts. As far as possible, the principles of commercial credits will be considered in about the same order as followed before in discussing American cases and attention will be directed to parallel rulings.<sup>1</sup>

I. A bank may not cancel its clean irrevocable letter of credit under which a third party has negotiated drafts, properly drawn by the beneficiary.

*Re Agra & Masterman's Bank (ex parte Asiatic Banking Corp.)* (1865) 36 L.J. Ch. 222.

1. The Agra and Masterman's Bank issued to Dickson Tatham & Co. the following letter of credit:

"You are hereby authorized to draw upon this bank at 6 months' sight to the extent of £15,000 sterling and such drafts we undertake thereby to honor on presentation. This credit will remain in force for

<sup>1</sup> The abbreviations refer to the following law reports.

<i>Abbreviations</i>	<i>Meaning</i>
Eq.	Equity
H. L.	House of Lords
H. & C.	Hurlstone & Coltman
K. B.	King's Bench Division
L. J.	Law Journal
L. R.	Law Reports
L. T.	Law Times Reports
L. T. O. S.	Law Times Reports Old Series
Q. R.	Quebec Reports
T. L. R.	Times Law Reports
I. R.	Irish Reports

12 months from this date and *parties negotiating bills under it are requested to endorse particulars on the back hereof.*"

2. Dickson, Tatham & Co. drew bills under this letter and sold them to the Asiatic Banking Corporation which made the proper indorsements on the reverse side.

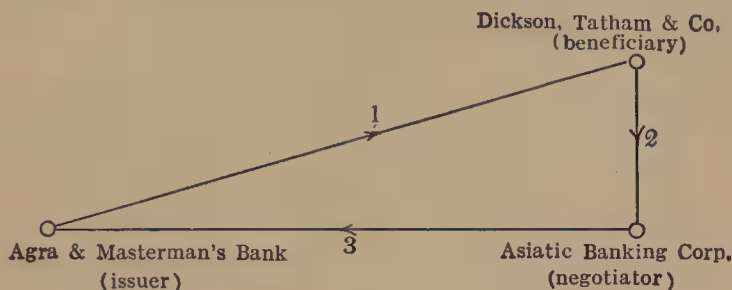


FIG. 10

3. The Bank presented the drafts for payment to the Agra & Masterman's Bank, but it had become insolvent and the receivers refused payment because of a counter claim against Dickson, Tatham & Co.

*Decision.*—The court described the content of the letter of credit as follows:

"The first part of the letter is the authority which is given to Dickson, Tatham & Co.; the second part of the letter is evidently, in substance, addressed to the persons who were to negotiate the bills. It is plain that the letter was given by the bank with a view to its being shown to persons who were to negotiate the bills and to make the advances upon the faith of that letter. The last passage in that letter is: 'Parties negotiating bills under it are requested to endorse particulars on the back hereof.' It is plain from that part that the letter was, in truth, addressed, though not in form, still in substance, to the persons by whom those bills were to be negotiated."

The court held that the Asiatic Banking Corporation, as negotiators of the drafts, were entitled to payment from the receivers of the Agra Bank, regardless of any claims against the drawers.

*Comment.*—The defendant bank issued an instrument which in every respect was a true letter of credit. It contained an

authorization to the beneficiary to draw his drafts and a promise to any party purchasing the bills that they would be honored. The credit was not conditioned upon the presentation of any documents and contained a fixed date of maturity, namely, twelve months, without mentioning the right of cancellation. Hence the instrument was a clean, irrevocable letter of credit, which permitted the beneficiary to draw his drafts and assured payment to any third party who bought the bills.

The right of a party who has negotiated the drafts of the beneficiary on the reliance of a letter of credit is also upheld in a Canadian case, *Sovereign Bank of Canada vs Bellhouse* (1911) Q.R. 23 K.B. 413, where the court expressed these views:

"A person who induces a bank to issue to him a letter of credit may by his subsequent conduct give the bank cause for canceling it but not if the customer secured the letter of credit from the bank in favor of another person. In that event the customer cannot oblige the bank to cancel it for the contract is between the bank and such other person, not between the bank and its customer. A bank cannot cancel a letter of credit once it has been transferred to a third party."

The same principle was involved in *Oriental Banking Corp. vs Lippert & Co.* (1875), 5 Buchanan's Reports, p. 152, tried in a South African court. The defendant had given the beneficiary the following letter of credit:

"We hereby beg to place at your disposal a credit of £5,000 to be used in your draft or drafts on us at any sight convenient to you. All drafts against this letter of credit to bear the above L. No. E, No. 7 and to be endorsed on the back of same. This letter of credit to be in force for three months from date, and all drafts to be issued and negotiated before that date, viz.: Sept. 10, 1875. This letter to be returned to us as soon as fully used or expired. We now hereby engage with you and all bona fide holders of drafts against this letter of credit to honor all drafts issued against the same on presentation, provided they are drawn in conformity with the above terms."

The beneficiary drew his drafts and sold them to the Oriental Banking Corporation. The bank presented the bills to Lippert, the credit issuer, but he refused to honor them on the ground that they had been made not to finance a shipment of diamonds but to furnish funds for the personal use of the drawer. This

condition was not stipulated in the letter of credit which was clean in form; and so the court properly ruled as follows:

"These letters of credit were open letters of credit and the only conditions they contained were as to the limitation of the amounts, the observance of certain marks upon the drafts to be drawn by virtue of the letter of credit, the manner in which they were to be endorsed, and the time within which the drafts were to be used and negotiated." (See *Johanessen vs Munroe*, p. 72.)

II. A revocable letter of credit may be canceled by the issuing bank upon notice to the beneficiary.

*Panoutsos vs Raymond Hadley Corporation* (1917), 117 L.T. K.B. 330.

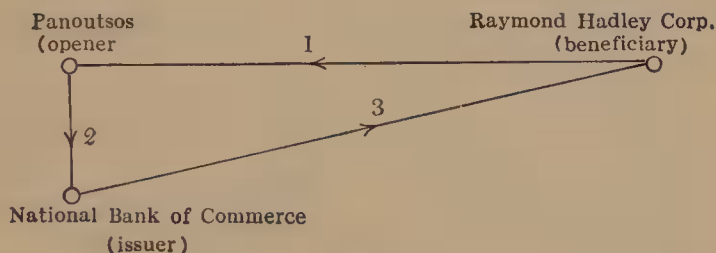


FIG. 11

1. On Sept. 27, 1915, Raymond Hadley & Co. of New York entered into an agreement to sell to Panoutsos, a Greek importer, 4,000 tons of flour, shipment to be evidenced by a bill of lading dated not later than Nov. 7, 1915. Each shipment was to be regarded as a separate contract. The terms of sale were cash against documents in New York under a so-called "confirmed" bankers' credit.

2. Panoutsos opened a letter of credit through the National Bank of Commerce in New York.

3. On Oct. 16, this bank informed the beneficiaries by letter that a credit had been opened, but the communication contained no guarantee as to the period of the credit which was thus revocable in form.

On Oct. 21, the sellers made a shipment of flour which was paid.

On Oct. 27, they took exception to the credit on the ground that it was revocable.

On Nov. 15, they asked for an extension of time from the buyer who gave his consent.

On Nov. 25, the beneficiaries were informed by the National Bank of Commerce that it assumed no responsibility for the continuance of the credit which could not be construed as being "confirmed."

On Dec. 13, the bank advised the beneficiaries that the credit had been canceled. Thereupon the sellers canceled the balance of the sales contract on the ground that the credit had not been opened in accordance with the contract. The buyer refused to accept the cancellation of the balance of the contract and the matter was referred to arbitrators. Their findings were not accepted and the matter was carried to court.

*Decision.*

"While the sellers had waived for a time the condition as to the 'confirmed' credit this fact did not bind them to continue to waive it until the completion of the whole contract; but the sellers could not cancel the balance of the shipments without giving to the buyer reasonable notice of their intention to cancel it."

*Comment.*—The decision in the above case involves the contract of sale between buyer and seller rather than the letter of credit between the seller and the bank. However, the case is of interest in that it is probably the first mention in a British Court of record of the term "unconfirmed" credit. The court apparently regards this type of credit as one which may be canceled by the bank and so apparently considers an unconfirmed credit the same as a revocable credit. According to American practice the credit in question is not unconfirmed but merely revocable. It was not an unconfirmed advice of the National Bank of Commerce informing the beneficiary of the opening of a credit by a foreign bank, but the communication was a revocable credit issued by the National Bank of Commerce itself. The court apparently accepts the principle that a bank may rescind its revocable letter upon giving notice to the beneficiary.

✓ **III. An unconfirmed advice of a credit may be canceled by the adviser without notice to the beneficiary.**

*Cape Asbestos Co. vs Lloyds Bank*, June 24, 1921, *Weekly Notes*, 274.

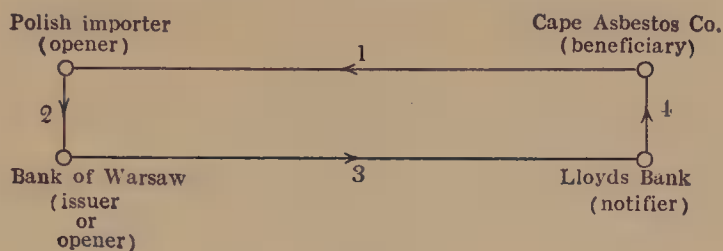


FIG. 12

1. The Cape Asbestos Co., a British firm, agreed to ship to a Polish concern 30 tons of asbestos boards at £160 per ton f.o.b. London.

2. The buyer arranged for a credit with the Banque de L'Est of Warsaw.

3. This bank instructed Lloyds Bank of London to inform the beneficiary of the credit.

4. On June 14, Lloyds Bank sent the beneficiary the following communication:

"We beg to inform you that we have received advice by telegraph from Banque de L'Est, Warsaw, of the issue of a Credit in your favor for £1,620, say sixteen hundred and twenty pounds, to be availed of meanwhile by your draft on us at sight accompanied by Invoice and Bill of Lading (in complete set) to order of Lloyds Bank, Ltd., covering shipment of 30 tons asbestos sheet consigned to the buyers at Warsaw. This is merely an advice of the opening of the above mentioned credit and is not a confirmation of the same."

The sellers made a partial shipment of the boards and, on presenting the document to Lloyds Bank, received part of the amount for which the credit had been opened.

On Aug. 4, the Warsaw bank informed Lloyds Bank of the withdrawal of the credit, but the latter institution, under pressure of business, failed to send notice of cancellation to the beneficiaries.

They made another shipment, and on Oct. 2 presented documents to Lloyds Bank which refused payment. The invoice was for more than the balance of the credit and the bills of lading were made out, not to the bank, but to the buyer who obtained possession of the goods. They withheld payment from the sellers who therefore brought suit against Lloyds Bank.

*Decision.*—The court held the bank was under no legal obligation to give notice to the beneficiary.

*Comment.*—In order to understand the principle involved in the above case it is necessary first to determine the nature of the communication sent to the Cape Asbestos Co. by Lloyds Bank. It frames the address to the beneficiary by writing:

“We beg to inform you that we have received advice by telegraph from Banque de L’Est, Warsaw, of the issue of a Credit in your favor”; and closes with the statement that, “This is merely an advice of the opening of the above-mentioned Credit and is not a confirmation of the same.”

From the text it is not clear whether the Warsaw bank had opened a revocable or irrevocable letter of credit. Neither of these two expressions are used and no mention is made of the right of cancellation by the Warsaw bank. Besides there is no fixed expiration date which should appear in an irrevocable credit. The credit therefore lacks the essential feature of either the revocable or the irrevocable form. The legal relation between the beneficiary and the Warsaw Bank apparently is left uncertain, since the court in the above case expressed no opinion on this subject.

The case is confined entirely to the relation between the beneficiary and the notifying bank. Its advice is none too carefully worded, since it refers in the beginning to “The issue of a credit,” and at the close to “The opening of the above-mentioned credit.” From these expressions it is difficult to determine whether the credit is domiciled with the Warsaw bank or with Lloyds. From the statement that “This is merely an advice of the opening of the above mentioned credit and is not a confirmation of the same,” it would appear that Lloyds have assumed no obligation. Therefore, whether or not the credit was revocable by the Warsaw bank, it was undoubtedly unconfirmed by Lloyds, which possessed the right to refuse payment to the beneficiary. The problem under consideration is whether or not a bank which has advised the beneficiary of the opening of a credit can refuse to purchase the drafts of the beneficiary without having given him previous notification of its intention.

The court held that the advising bank was under no legal obli-

gation to give the beneficiary notice of its intention. The equity of the decision rests upon the question as to whether the credit was domiciled with Lloyds or with the Warsaw bank. The answer can only be found in the communication between the two banks. If the Warsaw bank requested Lloyds to open a revocable credit and issue its letter, this communication would therefore evidence a revocable credit of Lloyds Bank. If this institution wished to exercise the right to cancel its own credit the beneficiary would be entitled to a notice of this action. If on the other hand the Warsaw bank had opened the credit and had asked Lloyds merely to inform the beneficiary of the existence of the credit a different situation would arise. If the credit is domiciled with the Warsaw bank, then Lloyds is acting not as the opener but as the adviser of the credit. By informing the beneficiary of the establishing of a credit at the Warsaw bank, Lloyds assumes no obligation toward the beneficiary.

At this point it is well again to consider the significance of the act of confirmation. If Lloyds had confirmed the credit, the bank would have engaged itself to honor the drafts of the beneficiary, but in the above case Lloyds had not given its confirmation, and so had not extended an assurance to the beneficiary that it would purchase his drafts. If the credit were domiciled with the Warsaw bank, a refusal by Lloyds to purchase the drafts of the beneficiary might not work hardship on him, since he might still be able to find another bank willing to buy bills drawn on the Warsaw bank. Therefore, if the above letter can be interpreted to mean that the credit was opened at the Warsaw bank, and was still available to the beneficiary even though Lloyds refused to purchase his drafts, in that event Lloyds bank was under no obligation to give notice of its intended action.

However, if the expression that the credit is to be availed of "by your drafts on us" (Lloyds) signified that the credit was opened with Lloyds and that the beneficiary was precluded from drawing his draft on the Warsaw bank or any other institution, then it would appear that, as a matter of fair dealing Lloyds bank was required to give the beneficiary notice of the cancellation of *its* credit.

The decision in the above case leaves unsettled several issues which arise from the cancellation of an unconfirmed, revocable

credit, such as the following, (a) has the Cape Asbestos Co., as beneficiary, any redress against the Warsaw bank, as credit opener? (b) Has the Warsaw bank, as credit opener, legal remedy against Lloyds bank, as notifier, for its failure promptly to advise the beneficiary of the cancellation of the credit?

It would seem that the entire case was tried on the wrong issue. The beneficiary had failed to observe the term of the credit in presenting an invoice in excess of the stipulated amount, and a bill of lading drawn on the buyer instead of to the order of Lloyds Bank. This institution could therefore have refused payment directly on the ground that the beneficiary had failed to comply with the terms of the credit.

#### IV. A bank may be liable for damages for canceling an irrevocable letter of credit.

*Bank of Toronto vs Ansell* (1875) 7 Revue Legale Q.B. 262.



FIG. 13

1. Ansell, who was leaving for England to purchase goods, obtained for himself from the Bank of Toronto the two following letters of credit:

“Bank of Toronto,  
Montreal, 17th Jan., 1873.

To D. A. Ansell, Esq.,  
Montreal.

At the request of our friend Mr. D. A. Ansell, I have opened a credit in your favor with the ‘City Bank, London, England,’ to be availed of by your cheques upon ‘The City Bank, London, England,’ on demand, *before the first day of May next*, to the extent of three hundred pounds sterling.

Each draft must have upon its face ‘Drawn against Bank of Toronto, Montreal Branch, credit No. 48, dated 17th January 1873.’

You will please advise the City Bank, London, of any drafts drawn under this Credit.

Your obedient servant,

(Signed) .....

Manager."

"Bank of Toronto,

Montreal, 17th Jany. 1873

No. 49.

To D. A. Ansell,

Montreal.

At the request of our friend Mr. D. A. Ansell, I have opened a credit in your favor with the City Bank, London, England, to be availed of by your drafts, upon 'The City Bank, London, England,' at ninety days' sight before the first day of June next, to the extent of three thousand pounds sterling, for the invoice value of goods, glassware and groceries shipped to Montreal.

Each draft must bear upon its face the words 'drawn against Bank of Toronto, Montreal Branch, credit No. 49, dated 17th January 1873' and be accompanied by invoice, and bills of lading filled up to the order of the shipper and endorsed in blank.

Insurance to accompany the bills of lading.

You will please advise the City Bank, London, of any drafts drawn under this credit.

N.B.—All the bills of lading, except the one retained by the Captain of the vessel, are to accompany the drafts."

On the reverse side of the letter of credit, Ansell signed the following agreement:

"I undertake to provide for all cheques which shall be drawn under the same by payment of the amount thereof to you in Montreal, in currency, at the rate of exchange at which you may be then drawing, together with commissions and interest, such interest to be at the rate of 5 per cent per annum, or at the current rate of interest in London, if above 5 per cent. This obligation is to continue in force, and to be applicable to all transactions, notwithstanding any change in the composition of our firm, or in the users of the credit, whether such change shall arise from the accession of any partner or partners. A deposit of notes and drafts made as collateral is at all times to be maintained in a satisfactory condition."

2. On the strength of these letters of credit, Ansell made purchases in England, and to pay for them drew drafts on the City

Bank of London. This institution, acting on a cable from the Bank of Toronto, refused to honor the drafts and informed Ansell that the credit was canceled.

Ansell brought suit for damages against the Bank of Toronto whose act of cancellation, it was claimed, had injured his credit standing and his business.

The bank, in reply, made the following contentions:

- a. No consideration had been given by Ansell to the bank.
- b. No time was specified for the duration of the credit, "but it was optional and revocable, and to subsist only so long as it was not canceled."
- c. Notes and drafts deposited by Ansell as collateral had been dishonored.

*Decision.*—The jury found in favor of the plaintiff and awarded him damages but these were later regarded as excessive by a court of review and were set aside.

*Comment.*—The letters of credit involved in the above case are somewhat atypical in form, since Ansell is opener and at the same time beneficiary. It therefore differs from the letters discussed in previous cases which involved three parties.

The letters in the above case do not contain any provision for cancellation, and the first is undoubtedly irrevocable in form since it contains a definite statement that the credit has been opened "with the City Bank, England, to be availed of before the first day of May next."

While the decision makes little effort to clarify the issues under consideration, the contentions of the litigants are of interest. It will be noted that the plaintiff bases his suit on the ground that the bank's act of cancellation has impaired his credit standing. The bank on the other hand defends its action by claiming that the beneficiary, through certain acts of his own, had weakened his credit standing and had thus given the bank justification for rescinding the letter of credit. Apparently the bank regarded the letter of credit merely as an expression of opinion regarding the rating of the beneficiary. However, a letter of credit in general has a deeper significance, since it is the means of inducing a third party to purchase the beneficiary's drafts which the credit issuer pledges to honor.

The principle that an issuing bank is liable for damages for impairing the credit standing of the beneficiary if a credit is revoked without cause finds support in *Graham vs Mahoney*

(1828), Irish Law Recorder (1st series), 385. Graham brought action against Mahoney, an officer of a bank which had granted a letter of credit and then dishonored it by refusing to pay the drafts of the beneficiary. The verdict was given to the plaintiff on the ground that his credit had been impaired by the action of the bank.

The extent of the damages arising from the cancellation of a credit issued in favor of the opener is considered in a later case of *Prehn vs Royal Bank of Liverpool* (1870), 21 L. T. 830.

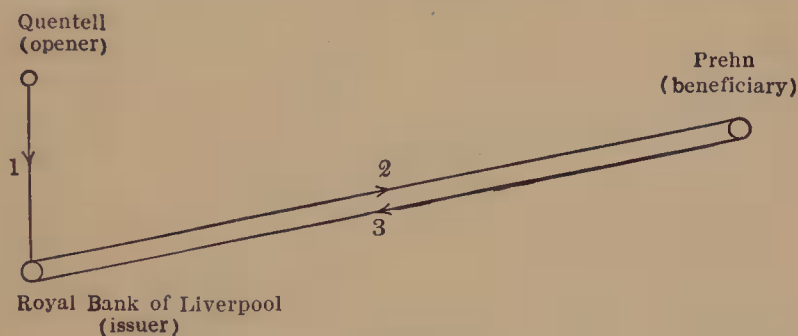


FIG. 14

1. Quentell, manager of the Liverpool branch of Prehn & Co., grain merchants, requested a letter of credit from the Royal Bank of Liverpool in favor of the agency of Prehn & Co. at Alexandria.

2. The bank granted the request in the following letter:

"I beg to inform you in reply to your note of yesterday, that your firm in Alexandria is at liberty to draw on the company to the extent of £20,000 in furtherance of grain shipments on the conditions stated."

3. Prehn & Co. at Alexandria drew drafts for £21,000 and Quentell covered them by paying the bank £22,000.

4. The bank stopped payment and refused to apply the cover to the drafts.

5. Prehn & Co. were therefore compelled to arrange credits with another bank but at heavy cost and sued to recover these expenditures.

**Decision.**—The opener was entitled to recover from the issuing bank damages covering the amount of the bill, commissions, and telegraphic expenses.

**Comment.**—While the courts in both *Ansell vs Bank of*

*Toronto* and in the above case recognized the claim against a bank revoking a credit issued in favor of the opener, still the amount of the damage has been given a narrow definition.

V. A bank cannot revoke its clean letter of credit because drafts presented by the negotiator have been drawn in violation of a sales contract of which the negotiator has no knowledge.

*Maitland vs The Chartered Mercantile Bank of India, London & China* (1869), 38 L.J. Ch. 363.

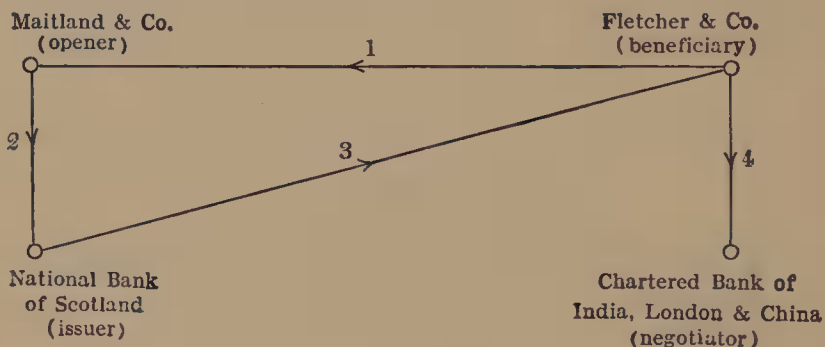


FIG. 15

1. Fletcher & Co. of Shanghai entered into a contract to ship goods to Maitland & Co of London.

2. Maitland & Co. requested the National Bank of Scotland to open a "marginal" letter of credit (letter of credit is written on a stub attached to blank bills of exchange) in favor of Fletcher & Co.

3. The manager of the bank issued the letter to Fletcher as follows:

"I hereby, for the National Bank of Scotland, authorize you to draw the annexed bill of exchange at 6 months' sight for two thousand pounds sterling on Messrs. Glyn & Co., bankers, in London, who will honor the same in conformity with its tenor if presented along with this letter of credit within one year from this date."

4. Fletcher & Co. in fraud and in violation of their contract of sale with Maitland & Co. drew under the credit bills not accompanied by shipping documents, and sold them to the Chartered Bank which had no notice of the contract between Fletcher & Co. and Maitland & Co.

*Decision.*

"A bona fide holder of a bill of exchange drawn under an open letter of credit, and taken by him on the faith of such letter of credit, has a right of action at law against the grantor of the letter of credit in case of his refusal to accept the bill."

*Comment.*—The letter of credit reproduced above differs from the usual form in that it does not contain the general promise to negotiators that bills will be honored. The letter is thus weaker than the instrument which forms the basis of the previous case of *Agra & Masterman's Bank, ex parte Asiatic Banking Corp.* Nevertheless, the court upheld the right of the third party as holder of the bill in due course. The two cases thus far cited involve credits which are clean, in the sense of requiring no documents. These credits are described in British law as "open," and the testimony in the above case presents the following distinction between open and documentary credits:

"Open credits are on the face of them engagements on the part of the party giving such credits to accept the drafts drawn under such credits unconditionally, except that generally there is a certain limit as to the time within which the credits are to be available; whereas 'documentary credits' are engagements to accept bills drawn under them subject to a condition or proviso on the face of the credit that the drafts, when presented for acceptance, are to be accompanied by bills of lading or shipping documents."

These cases also recognize the letter of credit as an obligation entirely independent of the contract of sale. This agreement cannot bind the bank which concerns itself only with the provisions of the letter of credit. These views were reiterated half a century later in the American cases of *American Steel Co. vs Irving National Bank* and *Frey vs Sherburne*.

VI. An issuing bank may revoke its letter of credit if drafts presented by the negotiator are drawn in violation of the credit. ✓

(a) Failure to observe general terms.

*Union Bank of Canada vs Cole* (1877), 47 L.J.Q.B. 100.

1. Cole & Co., London merchants, gave to Stevenson & Co. of Montreal the following letter of credit, which read in part as follows:

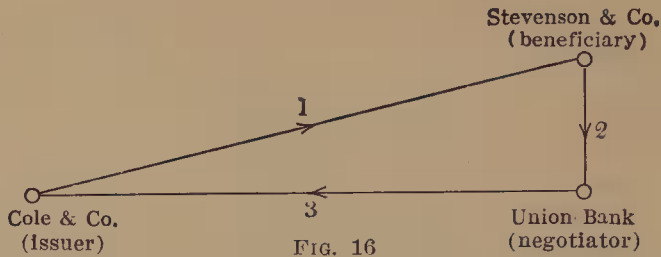


FIG. 16

"By request and for account of your good selves we hereby confirm a credit in your favor to the extent of £25,000, say twenty-five thousand pounds sterling, to be available by your draft or drafts upon us at sixty (60) days' sight.

The object of this credit is to provide for your reimbursements against shipments of grain to the U. K(ingdom) or Continent, as per instructions hereinafter named.

This credit becomes void if not used on or before the 31st day of December, 1874.

You will please state in the body of your drafts and advise us that they are drawn under credit No. 604 and of this date."

The letter contained a detailed description of the required documents.

2. Without performing the conditions of the credit, Stevenson sold his bills to the Union Bank of Canada. The bank for a short while held the letter of credit and so was in a position to be aware of the conditions, and although they were unfilled nevertheless negotiated the bills.

3. The Union Bank presented the drafts to Cole & Co. but they refused to accept them. The bank thereupon brought suit.

#### *Decision.*

"The conditions appear on the face of the document and it is found that something which the defendants have made a condition of the drawing of the bill and which ought to have been performed was not performed. I am therefore of the opinion that the plaintiffs cannot recover."

*Comment.*—The letter under consideration differs from the usual form. It was issued not by a bank but by the importer himself. Besides it contained no engagement addressed to the negotiators of the bills that they would be honored. Notwithstanding these defects, the court regarded the document as prac-

tically an "open" letter of credit. Furthermore, being documentary, it called for the furnishing of certain shipping documents. The negotiator did not insist upon the compliance with their condition and so had no claim against the issuer. The above case involved a documentary or conditional letter of credit and so must be distinguished from the cases of *Agra & Masterman's Bank* and *Maitland vs Chartered Bank*, both of which involved a clean letter of credit. (See also *International Banking Corp. vs Irving National Bank*; *Stein vs Hambro's Bank of Northern Commerce*, 9 Lloyd's List Law Rep. 433, 507, Dec. 8, 1921; *Urquhart, Lindsay & Co., Ltd. vs Eastern Bank*, 9 Lloyd's List Law Rep. 572, Dec. 5, 1921).

(b) Failure to insist upon actual purchase of merchandise. ✓

*Chartered Bank of India, Australia & China vs Macfayden* (1894), 64 L.J.Q.B. 367.

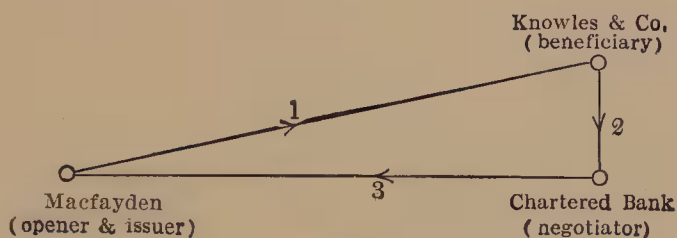


FIG. 17

1. Macfayden & Co., London importers, issued to Knowles & Co. of Batavia the following letter of credit:

"Messrs. Knowles & Co., Batavia.—Dear Sirs.—We hereby cancel our revolving credit opened in your favor on 8th July, 1892, and open in its stead the following extended credit for £5,000 (five thousand pounds) to be availed of by drafts on us at 3, 4, or 6 months against produce bought and paid for by you, but not immediately ready for shipment, but to be shipped within two months of the passing of the drafts and documents in full cover of same, to be sent in to the bank through whom you negotiate for despatch to us by first mail after receipt. On shipping documents being handed to the bank the amount so covered shall again be available, provided that in no case shall the amount uncovered current at any one time exceed the sum of five thousand pounds sterling (£5,000). The produce bought under this credit you must hold under lien to us until the documents have been handed to the bank for transmission to us. Marine insurance will frequently be held covered on this side under our open cover, and in that

case the documents to be given in will only be a complete set of the bills of lading with the usual letter advising us that the insurance is to be covered on this side. When the letter is not given, then policies of insurance effected by you must be sent in with the bills of lading. This credit to continue in force for one year from this date. These are the terms on which we grant this credit, and we hereby undertake to accept on presentation, and pay at maturity, or take up under discount, all drafts drawn by you in conformity with the said terms and conditions.

Yours faithfully,

(Signed) .....

2. Knowles & Co., purporting to act under the terms of this letter, drew drafts upon Macfayden & Co., and sold them to the Batavia branch of the Chartered Bank of India, Australia & China.

3. The branch office forwarded the bills to the London office, which presented them to Macfayden & Co. They, however, refused to accept the bills which were said to be drawn in violation of the terms of the credit.

#### *Decision.*

“This was not an open letter of credit, intended to be shown to all the world, and if the banks are shown and act upon the letter, then they must act upon it as the letter itself states ‘in conformity with its terms and conditions.’ There was no contrast whatever, and no contractual relationship established between the bank and the defendants [issuer of the credit] by this particular letter of credit, and even if there were such a contractual relationship, then it would be a contract subject to the express conditions of the letter.”

*Comment.*—The above case further establishes the principle that a bank negotiating drafts under letters of credit must see that the terms are scrupulously observed.

#### (c) Failure to produce proper bill of lading.

*Brazilian & Portuguese Bank vs British & American Exchange Banking Corporation* (1868), 18 L.T.R. 823.

1. Maxwell & Co. of New York requested the New York branch of the British & American Exchange Banking Corporation to issue a letter of credit in favor of the Rio office of Maxwell & Co.

2. The bank accordingly issued to the Rio office of Maxwell & Co. the following letter:

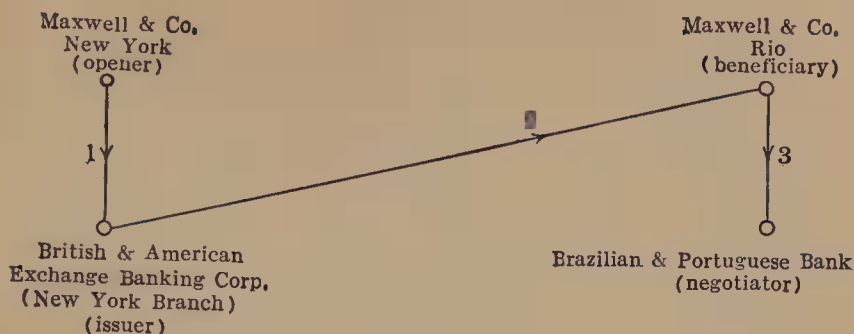


FIG. 18

"New York, 1st February, 1866.

GENTLEMEN:—We hereby authorize Messrs Maxwell, Wright & Co., of Rio de Janeiro, to value on you at ninety days' sight, for account of Messrs. Wright, Maxwell & Co. of New York, for any sums not exceeding £20,000 sterling, to be used as they may direct, for the invoice cost of coffee to be purchased for account of whom it may concern, and to be shipped from the ports of Rio de Janeiro or Santos to New York, Philadelphia, or Baltimore. The bills must be drawn in Rio de Janeiro prior to the 1st day of January, 1865, and advice thereof given to you in original and duplicate, such advice to be accompanied by bill of lading filled up to order of the shippers, and blank endorsed with abstract of invoice thereon for the property shipped as above. All the bills of lading issued (except one to be forwarded us by the vessel and the one retained by the captain of the vessel) to be forwarded direct to you. Original invoice to be forwarded to us. This credit to be revolving, as per margin. And we do hereby agree with the drawers, endorsers, and bona fide holders of bills drawn in compliance with the terms of this credit, that the same shall be duly honored on presentation at your office in London.

We are, gentlemen, your obedient servants.

The B. & A. B. Corporation (Limited)  
(Signed) .....

Assistant Manager.

For 20,000 pounds sterling. Please sign  
bills as being drawn under credit, No. 63.

Dated 1st February, 1864.

N.B.—Insurance at New York to Messrs. Wright, Maxwell & Co. War risk to be covered unless the coffee be shipped by neutral vessels."

The following memorandum was in the margin of the letter of credit:

"This credit to be revolving, and open as often as covered by ship-

ment in accordance with the within-named conditions, and Messrs. Maxwell, Wright & Co. are hereby authorized to value on you to the extent of £10,000 sterling against the same, in anticipation of sending forward bills of lading, notwithstanding anything herein expressed to the contrary."

3. The Rio firm exhibited the letter of credit to the Brazilian & Portuguese Bank which thereupon purchased the drafts supposedly drawn in accordance with the terms of the credit. But the bills of lading, four in number, stated that the vessel was "bound for St. Thomas for orders." Only two bills of lading were delivered to the negotiating bank which forwarded only one with the drafts to the British and American Exchange Bank in London. This institution refused to honor the drafts on the ground that the bills of lading were not in accordance with the terms of the letter of credit. The Brazilian Bank thereupon brought suit.

*Decision.*

"The conditions in the letter of credit on which the defendants engaged to accept to the amount of £20,000 were unperformed, and consequently the obligation upon them to accept, under the letter of credit, never attached, and the plaintiffs' action therefore could not be maintained, upon the two following grounds:

First, that the bills of lading directed the vessel 'to St. Thomas for orders,' and therefore gave power to the defendants (if at all) to obtain and deal with the goods at St. Thomas alone, and not at either of the three ports contracted for: and that the defendants had no power of themselves to cause the goods to be delivered at one of the ports, and if they could acquire such power by communication with the shippers either at Rio or New York, the order could only be obtained and transmitted to the captain after a long delay, whereas they were required to accept the bill of lading at once, on the 21st November;

Secondly, that the possession by the defendants of all the *bills of lading* issued, except the one retained by the captain, was one of the conditions of the contract, and constituted the sole security to the defendants for the delivery of the coffee to them when it should be landed at its port of destination; and one of such bills having been retained by the plaintiffs, it was in their power, so long as they retained it, to endorse it in blank, to order the coffee to be forwarded to any port they might think fit to name, and to take *possession of it*

on arrival there, and thus deprive the defendants of any security at all for the advances they might have made."

VII. An issuing bank may revoke its letter of credit if the drafts presented by the beneficiary are drawn in violation of the credit.

*Morgan vs Larivière* (1875), L.R. 7 H.L. 423.

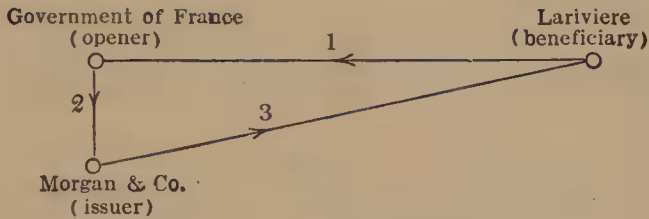


FIG. 19

1. During the Franco-Prussian War, Larivière, a British contractor, entered into a sales agreement to supply the French Government with a certain number of cartridges. According to the agreement, deliveries were to be made at fixed periods of time and with the utmost speed.

2. The French Government appointed Morgan & Co. as its general fiscal agent in London.

3. Morgan & Co. issued to Larivière a letter of credit which read in part as follows:

"We are instructed by M. Joulin (representative of the French Minister of War) to advise you that a special letter of credit for £40,000 has been opened with us in your favor and that it will be paid to you rateably as the goods are delivered upon receipt of certificates of reception issued by the French Ambassador, or by M. Joulin."

Larivière, after effecting a few deliveries, failed to make certain shipments in time and the bankers canceled the credit in the following communication:

"M. Joulin now informs us that as the time has already expired within which the deliveries of goods were to be made, and to pay for which this credit was opened, no farther deliveries can be made under it, and we are not to make any farther payment in virtue of it. Under these circumstances, in accordance with the instructions, we

request that you return us our letter dated the 1st ultimo, and take note that the credit advised therein is withdrawn and canceled."

### *Decision.*

"'Rateably' appears to be intended to mean that the documents to be presented to the appellants [Morgan & Company] were to be the documents of the reception of the cartridges. . . . They were to pay for them not on receipt, or on approval by the French Authorities, but on the production of the certificates; and the respondent [Larivière] cannot allege that they were improperly withheld, as he was wholly unable to fulfill his contract in the time, and he cannot claim any further sum than he has received, not being able to produce the required evidence of delivery."

*Comment.*—This case continues the general principle that the terms of a credit must be strictly observed. In the three preceding cases, the relations between the issuer of the letter of credit and the negotiator were considered. The above case presents the relation between the issuer of the letter and the beneficiary who failed to produce a certificate of delivery required under the credit.

**VIII. An issuer of an authority to draw is liable to the opener if the terms are not observed by the beneficiary.**

*Borthwick vs Bank of New Zealand*, 17 L.T.R. 2.

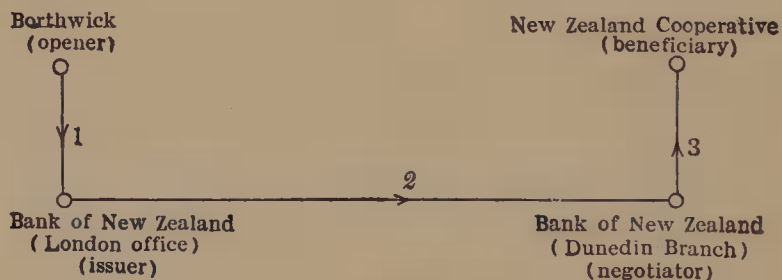


FIG. 20

1. Borthwick, a British importer of meats, requested the Bank of New Zealand to issue its authority to draw (see Chap. VIII) in the following application:

"I request that you will authorize your office at Dunedin to negotiate the drafts of the New Zealand Coöperative & Agency Co. (Ltd.) on me at 60 days' sight to the extent of £10,000 at any time within two

months from this date, and in consideration of your doing so, I hereby undertake to accept such drafts on presentation, and to pay them in London at or before maturity, it being understood that it is entirely optional with your office at Dunedin to negotiate drafts under this authority. The drafts are to be accompanied by shipping documents (i.e., bills of lading, invoice, and insurance policy) purporting to represent lamb and mutton of an equivalent value at not exceeding  $3\frac{3}{4}$  pence and  $2\frac{1}{2}$  pence per pound, c.i.f. respectively, inclusive of charges, shipped to London, but you are not to be responsible in the event of any misrepresentation as to quantity, quality or value thereof. On due payment of any draft the relative documents are to be given up to me."

2. The London office authorized its office at Dunedin, New Zealand, to purchase the drafts of the Coöperative Co.

3. The Dunedin office instructed the Coöperative Co. to draw its drafts.

The Coöperative Co. drew its drafts on Borthwick and sold them to the Dunedin branch which forwarded them to the London office. The bills, unaccompanied by the documents, were presented to Borthwick who accepted them. When the consignment arrived it was found to be partially damaged but the loss could not be recovered since the policies read: "to pay a total loss by total loss of vessel only."

The Coöperative Co. went into liquidation, so Borthwick sought to recover damages from the bank which, he claimed, had committed a breach by negotiating drafts without having the customary "all risks" policy attached.

*Decision.*—The court held that it

"had no doubt that the contract contained in the letter of credit was a contract in the fullest sense of the term. The letter stated the terms on which the defendants were to negotiate and the plaintiff was to accept the drafts. When drafts were brought to the bank the first consideration would be whether the drafts were such as the plaintiff would accept, and therefore the representative of the bank ought to have examined the documents attached to see if they were such as were stipulated for by the plaintiff, the object of the stipulation being to protect the plaintiff. His Lordship was satisfied from the evidence which had been given that the proper form of policy was an 'all risks' policy. The letter of credit said expressly that in certain events the defendants were not to be responsible. That was a clear indica-

tion that they were to have some sort of responsibility, and in his Lordship's opinion their responsibility extended to everything not expressly excepted. The documents and drafts came forward in the ordinary course, and the bank sent the drafts to the plaintiff for his acceptance, but retained the documents. The plaintiff could not conjecture that one of the policies was not in the ordinary form, and he accepted the drafts. In fact no one examined the policies until after the loss had occurred. The plaintiff first called on the shippers for an explanation, but it was idle to have recourse to them, for the company went into liquidation. Then the plaintiff made his claim on the bank. It was said that the bank was not responsible, and an attempt was made to show that there had been some negligence on the part of the plaintiff which had misled the defendants. That was not the case. The defendants were, in his Lordship's opinion, liable to the plaintiff."

*Comment.*—This case deals not with the letter of credit but with the authority to draw. As explained above this document instructs a bank to buy the drafts of a seller of merchandise. In buying their bills, the negotiator and later the issuer of the authority must insist upon strict observance of the terms by the seller. The Bank of New Zealand neglected to see that the drafts were accompanied by proper insurance policies and so was liable to the opener of the authority to draw. This case differs from the four preceding citations in that it discusses the relation between the opener and the issuing bank. This institution is held responsible if it makes payment to a beneficiary who has not furnished the required documents.

**IX. A bank negotiating drafts under a letter of credit is not responsible for the validity of the documents presented by the beneficiary.**

(a) Bill of lading.

*Woods vs Thiedeman*, 1 H.V.C. 477.

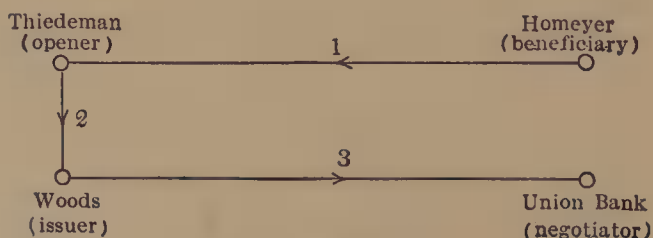


FIG. 21

1. Homeyer, a Prussian exporter, agreed to ship a cargo of wheat to Thiedeman, a British importer.

2. Thiedeman wrote to Woods, his banker, as follows:

“We shall feel obliged by your requesting the Union Bank of London to accept the drafts of Mr. Homeyer of Wolgast for £2,400 against properly endorsed bill of lading of 8,320 scheffels of wheat per ‘Anna’ F. K., master, on our account.”

3. In accordance with this letter, Woods sent instructions to the Union Bank, which accepted the drafts of Homeyer and debited Woods’ account. Homeyer, however, presented a forged bill of lading and no cargo was actually placed on board the vessel. Thiedeman refused to reimburse Woods who therefore brought suit.

*Decision.*

“The only argument for the defendant (Thiedeman) is that the words ‘bill of lading’ import a genuine bill. I am of the opinion that they meant such a document as Homeyer might send, or which was in the course of coming, professing to represent a cargo of wheat. . . . The plaintiffs were not to take upon themselves the risk of the bill of lading being a genuine document. The authority was to accept bills against a bill of lading properly endorsed, and no one supposed that the documents produced would be a forgery.”

“Held. The banker had not taken upon himself the risk of the bill of lading being forged and was entitled to recover from their customer the amount they had paid in respect of the bill of exchange.”

*Comment.*—The several decisions considered above clearly place upon the negotiating bank the responsibility of seeing that the conditions of a credit are observed by the drawer of the draft. The case of *Woods vs Thiedeman* limits the liability of a negotiating bank to the shipping documents themselves. The bank in no way can be expected to guarantee the genuineness of the bill of lading or any other document in the commercial set. This principle is also affirmed in *Ulster Bank vs Synnott*, 1871, R. 5 eq. 595, which held that “on acceptance of a draft against a bill of lading which was forged, the banker was not bound to see that the bill of lading was genuine but that it was regular on the face of it.” The same view was supported in *Guaranty Trust Co. vs Hannay* (1918, 119 L.T. 321; 87 L.J.K.B. 1223).

This case arose out of the famous Knight-Yancey cotton frauds and was one of the hardest fought legal contests of recent years, being presented before both American and British courts. All these cases accept the view that banks should not be called upon to assume the commercial risks which arise in foreign trade. These risks are still very great, notwithstanding the improvement in business methods and the development of commercial legislation. The possibilities of losses to banks on forged bills of lading may be illustrated in the frauds committed in the United States by one Pateriotis. For some time he had been engaged in exporting foodstuffs to Greece. After conducting his business along legitimate lines, he later entered into fraudulent operations. He would agree to ship 2,000 bags of sugar to a Greek importer who would open a confirmed letter of credit with a New York bank. Pateriotis would then obtain a bill of lading for 2 bags of sugar, raise the amount to 2,000 bags and present his documents to the New York bank which would then make payment under the letter of credit.

(b) Certificate of analysis.

*Basse and Selve vs Bank of Australasia* (1904), 90 L.T., p. 618.



FIG. 22

1. Basse and Selve, German manufacturers, requested the Deutsche Bank to open a credit in favor of A. Oppenheimer of Sydney, Australia.

2. The Deutsche Bank, having no branch at Sydney, asked the Bank of Australasia to instruct its Sydney branch to negotiate the drafts of Oppenheimer.

3. The Bank of Australasia wired its Sydney office as follows:

"Negotiate drafts of A. Oppenheimer at sight on Deutsche Bank (Berlin) London Agency £800 account. Basse and Selve (against) bill of lading, policy of insurance and certificate of analysis from Doctor

Helms (for) 100 tons cobalt one analysis not less than 5 per cent protoxide shipped by steamer (to) Europe. Credit expires on June 15th."

Oppenheimer presented to the Sydney branch the following documents:

- a. bill of lading covering "P.M. 2,680 bags containing 100 tons cobalt ore."
- b. policy of marine insurance.
- c. certificate of analysis from Dr. Helms, reading—

"A. OPPENHEIMER.—Dear Sir: The sample of cobalt ore marked P.M. 2680 bags representing 100 tons received from you on the 12th July gave the following results: 4.14 per cent cobalt, equal to 5.27 per cent cobalt protoxide in the dry ore.

A. HELMS."

The bank negotiated Oppenheimer's draft and forwarded it to the Deutsche Bank which in turn made payment. It was later discovered that although the sample given to Helms met the requirements of the credit, the ore itself was unsound and not worth shipping.

Basse and Selve sued to recover this loss from the bank.

*Decision.*

"The certificate on its face was regular and came within the meaning of the mandate, and there was no duty on the bank to see to the sampling. The bank was entitled to assume that the analyst had acted skillfully in making the analysis."

*Comment.*—This case continues the principle established in *Woods vs Thiedeman* that a negotiating bank is not responsible for the validity of documents attached to the drafts.

**X. A bank negotiating drafts under a letter of credit is not responsible for the quality of goods shipped by the beneficiary.**

*Chartered Bank of India, Australia & China vs Macfayden*, 64 L.J.A.B. 367.

(See p. 151.)

*Decision.*—In reply to the counterclaim of the defendant (issuer of letter of credit) against the plaintiffs, the negotiating bank, the Court held that the mere presentation of the bills of

exchange by the plaintiffs to the defendant "did not amount to a warranty or representation by the plaintiffs that produce had been bought and paid for by Knowles & Co. (beneficiaries) against which the bills had been drawn, and that the defendants were not entitled to recover from the plaintiffs the amount so paid."

*Comment.*—Previous cases have exempted negotiating banks from responsibility for the genuineness of documents. The case under consideration absolves a negotiating bank from liability for the goods themselves.

**Summary of American and British Cases.**—A review of the American cases presented in Chap. V and the decisions given disclose many legal principles in common. These may be summarized in parallel order according to the numbers given in the two chapters as follows:

## AMERICAN

1. A bank may not cancel its clean irrevocable letter of credit before its expiration date.

2. An irrevocable letter of credit may be canceled after its expiration date.

3. A letter of credit may be canceled by the issuer upon notice to the beneficiary; but not after he has drawn his drafts.

4. A bank cannot revoke its letter of credit because the drafts presented by the beneficiary have been drawn in violation of a sales contract.

5. A bank cannot revoke its letter of credit because drafts presented by the negotiator have been drawn in violation of a sales contract.

6. An issuing bank may revoke its letter of credit if drafts presented by the negotiator are drawn in violation of the credit.

## BRITISH

1. A bank may not cancel its clean irrevocable letter of credit under which a third party has negotiated drafts properly drawn by the beneficiary.

2. A revocable letter of credit may be canceled by the issuing bank upon notice to the beneficiary.

3. An unconfirmed advice of a credit may be canceled by the adviser without notice to the beneficiary.

4. A bank may be liable for damages for canceling an irrevocable letter of credit.

5. A bank cannot revoke its clean letter of credit because drafts presented by the negotiator have been drawn in violation of a sales contract of which the negotiator has no knowledge.

6. An issuing bank may revoke its letter of credit if drafts presented by the negotiator are in violation of the letter of credit.

7. An issuing bank may revoke its letter of credit if drafts presented by the beneficiary are drawn in violation of the credit.

8. An issuing bank is liable to the opener of a credit if the terms are not observed by the beneficiary.

9. A bank negotiating drafts under a letter of credit is not responsible for the quality of the merchandise shipped by the beneficiary.

a. failure to observe general terms.

b. failure to insist upon actual purchase of merchandise.

c. failure to produce proper bill of lading.

7. An issuing bank may revoke its letter of credit if the drafts presented by the beneficiary are drawn in violation of the credit.

8. An issuer of an authority to draw is liable to the opener if the terms are not observed by the beneficiary.

9. A bank negotiating drafts under a letter of credit is not responsible for the validity of the documents presented by the beneficiary.

a. bill of lading.

b. certificate of analysis.

10. A bank negotiating drafts under a letter of credit is not responsible for the quality of the goods shipped by the beneficiary.

## CHAPTER XII

### GERMAN COMMERCIAL CREDITS

**I. Pre-war Financing of Foreign Trade.**—During the early period of the commercial expansion of Germany, her overseas trade was financed largely by means of the trade bill. This instrument was drawn by the exporter on the importer directly and then discounted with a local bank. At times the importer made arrangements with a German bank to negotiate this bill and thus a form of the “Authority to Purchase” was extensively used. However, the method of financing foreign trade by a trade bill always proved unsatisfactory, since it resulted in drafts drawn on a foreign mercantile house and could be re-discounted only at a high rate of interest. Such a trade draft possessed a long maturity and so lacked liquidity. German merchants fully appreciated the greater value of bank credit over mercantile credit, but as their financial institutions were insufficiently developed at this period, it was necessary to turn their business over to British banks which until the last quarter of the nineteenth century handled the financing of the greater part of German exports and imports. The practice of German merchants and bankers to finance shipments through the British money market continued even after Germany had expanded her trade and had developed an organized banking system. Until 1914 a large number of German bills drawn upon German overseas banks were regularly disposed of in the London discount market. In time, German overseas banks specializing only in foreign trade financing were formed, and they gradually assumed the function of expanding German commerce, especially in South America and the Far East.

In no other country was there so close a relationship between banking and foreign trade, and German credits were known for their long maturity.

**II. Meaning of Terms Used by German Banks.**—In general the commercial credit practice of German banks departs very little from American or British usage. There is, however, con-

siderable difference in forms and terminology and these phases will now be considered. Uncertainty seems to prevail even among German bankers themselves as to the meaning and use of such terms as "Akkreditiv," "Gegenakkreditiv," "Rembourskredit" and "Trassierungskredit."

1. *Akkreditiv*.—It may be well to analyze first the Akkreditiv which has the broadest connotation in that it includes the Rembourskredit and Trassierungskredit. The Akkreditiv may be described briefly as an order given by a purchaser of goods to a bank which is requested to notify the credit and to make payment to a third party, the beneficiary. This instrument is quite unlike the American commercial letter of credit in which the bank authorizes a beneficiary to draw his drafts and engages that these will be honored on presentation. The German Akkreditiv may rather be compared with the American application signed by the importer who opens the credit and addressed to the bank which issues the credit. The Akkreditiv is in the nature of a contract which may be oral as well as written (see *Bürgerliches Gesetzbuch*, Civil Law Code, paragraph 675). The German commercial letter of credit is not subject to paragraph 363 of the *Handelsgesetzbuch* (Commercial Law) which requires an obligation to be in written form and which governs the traveler's letter of credit.

2. *Gegenakkreditiv*.—The Akkreditiv, as the American letter of credit, serves to assure the seller of ultimate payment. Because of the more or less continued rise in the price level in Germany there has been a greater need of protecting the buyer against rejection of the order for goods by the seller, and so the latter is often required to open a "Gegenakkreditiv" or counter credit with a bank in favor of the former. This instrument is not a true letter of credit but a letter of indemnity in which a bank agrees to compensate the buyer to a certain minimum amount in case the seller does not comply with the terms of the sales contract. This instrument is used only in conditions of extreme business uncertainty and will decline in importance with the return to stability.

3. *Rembourskredit*.—While the Akkreditiv may apply to domestic as well as to foreign transactions and may be either clean or documentary in the sense of permitting payment only upon presentation of shipping documents, the term Rembours-

credit covers only an importation of goods and so must necessarily be a documentary credit.

The most important document is the bill of lading. As mentioned in Chap. II, the "received for shipment" instrument is regarded in Germany as a valid bill of lading. However, receipts of shipmasters, forwarding agents, or even through bills of lading are not accepted by German banks as satisfactory tender unless instructions are so given by the openers of the credits. It may be worth while here to note that the bill of lading issued by a German carrier is merely a receipt of the goods and is not a document which can be used to transfer the title to the goods.

4. *Trassierungskredit*.—The Rembourskredit may call for the drawing of drafts at sight or on time and so may give rise either to a cash or an acceptance credit. Like the Rembourskredit, the Trassierungskredit applies only to documentary foreign credits but this instrument is further narrowed in its scope in that it permits only the drawing of time drafts on a bank. It is, therefore, never a cash but always an acceptance credit.

The Trassierungskredit may serve two functions. In the first place it may correspond to the American documentary acceptance credit which authorizes the drawing of drafts by the exporter on the importer's bank, or it may be used as a form of acceptance agreement according to which the bank permits the importer to draw drafts which correspond to what is known in the United States as "refinancing acceptances." A Trassierungskredit is sometimes called an "Akzeptkredit." The former term is used in considering the transaction from the viewpoint of the merchant drawing the drafts, while the latter expression is employed in referring to the position of the bank accepting the bills.

There seems to be considerable confusion in German bank literature between the letter of credit and the authority to purchase, which was described in Chap. VIII. The authority to purchase instructs the beneficiary to draw his drafts not upon a bank but upon an importer and thus gives rise not to a bank but to a trade bill. The authority is erroneously termed a letter of credit by one German writer who comments as follows: "If the bank binds itself to buy drafts drawn by the exporter on the importer, provided the documents are in compliance with the request of the importer, it is regarded as a confirmed letter of credit." (Repenning, "Das überseeische Remboursgeschäft

der deutschen Banken," p. 61.) One banking authority states that the only distinction to be drawn between a letter of credit and an authority to purchase lies in the method of charging commission which, in the case of the authority to purchase, is borne by the beneficiary selling the goods, while under the letter of credit it is carried by the opener who is buying the merchandise.

**III. Classification.**—1. *Transferability.*—German credits may be classified according to general principles which are familiar to American banks. In the first place, credits may be grouped according to whether or not they are transferable. Most credits are addressed to a specified beneficiary and so are non-transferable. However, it is possible under exceptional circumstances for a German bank to issue a credit which is payable to the order of a beneficiary who may thus make an assignment to another party, or the instrument may be made payable to bearer. The latter case, however, is very rare. On this subject Dr. Alfred Jacoby, a German authority on commercial credits, writes as follows:

In no case, unless the credit is stated as "transferable," will a German bank permit the beneficiary to assign his rights to another party so that the latter, on the basis of the transferred credit, may demand payment from the bank. It will, however, be impossible to prevent a freight forwarder or another bank, upon direct notification of the beneficiary to the bank, to present documents and request payment. It is also possible for the beneficiary to instruct another party to ship the goods and to present the documents to the bank. In this case a difficult task devolves upon the bank to determine whether or not payment is to be made. If the bank pays, it may encounter objections on the part of the opener, because payment has been made to a party other than the beneficiary. If payment is refused, the opener may incur damages since he delays in accepting the offered documents. It is impossible to make a general decision; the bank must determine whether payment corresponds to the will and intention of the credit opener."

2. *Location.*—Since the outbreak of the war, letters of credit have been used in domestic as well as foreign trade. Before 1914 domestic letters of credit were practically unknown in Germany, but the instability of prices and the decline of business morality led to the wide use of this instrument as a means of binding the contract between buyer and seller. Also, as prices

mounted to abnormally high levels, business transactions could not be financed merely by mercantile credit, and so it was necessary to utilize bank credit with its greater expansibility.

3. *Number.*—A letter of credit is usually issued as a primary document. However, a German credit may be the basis of a secondary or ancillary credit. For example, a beneficiary of a credit may ask his bank to open another credit in favor of a firm supplying him with goods. Thus the first party is the beneficiary under the original credit, and the opener of the ancillary credit.

4. *Qualification.*—Letters of credit may also be grouped as either clean or documentary, depending upon whether payment is conditioned or qualified upon the presentation of documents evidencing title to property. This may consist of stocks and bonds or other forms of securities, but in most cases it may be merchandise either in transit or in a warehouse.

5. *Cancellation.*—Letters of credit are either revocable or irrevocable. However, these terms have a rather peculiar significance in German commercial credit practice. In the United States and also in Great Britain, the question of revocability applies to the issuing bank which may or may not possess the right of rescinding its offer to the beneficiary. In revoking a credit, an American bank may be acting on its own initiative or on the instruction of the party who has opened the credit. This revocation may be made even without notice to the beneficiary. In German credits, the subject of revocability refers only to the relation between the person opening the credit and the bank issuing the letter.

6. *Confirmation.*—The term confirmation, as in the case of American credits, expresses the relation between the bank notifying a credit and the beneficiary. Confirmation refers to the ability or inability of this notifying bank to withdraw its obligation of honoring the drafts of the accredited party. In the case of German credits, confirmation refers to the bank issuing the credit as well as to the notifying bank. Thus in German commercial practice a distinction is drawn between the question of revocability and that of confirmation. But as a matter of fact if a credit is irrevocable by the opener, the bank usually considers itself bound to issue a confirmed letter of credit. In fact many German banks will absolutely not handle a credit which the opener refuses to have the issuer confirm. This view

has been unanimously accepted by the members of the Berlin Bankers' Association. If the party, opening a credit irrevocable by himself, does not wish the bank to add its confirmation, he must so state his request in his application, otherwise the bank will issue what may be regarded as an irrevocable, confirmed letter of credit. On this subject the author, for the Federal Reserve Board addressed letters to several large German banks, and from one of them received the following answer:

"We regard all irrevocable credits as confirmed, for the following reasons: The purpose of opening an irrevocable credit is to give the beneficiary an unqualified claim to payment on a bank. An irrevocable credit is opened, because the opener of the credit is pledged by contract to do so, and besides the seller has agreed to the sales contract on the belief that the bank will execute the order under any circumstances. The bank which refuses to pay a credit after having opened an irrevocable but unconfirmed letter of credit must consider that it places itself by this act in a difficult position, if on the one hand the opener of the credit gives instructions to refuse payment, and on the other hand the beneficiary insists upon payment. In order to avoid these difficulties, a bank from the beginning must state that it does not regard itself obligated in any way to the beneficiary. If the bank then makes such a statement of its waiver of responsibility it runs the risk of not acting according to the instructions of the opener who may not have had the thought of revocation in mind. The beneficiary on the other hand will not be able to do anything with such a credit as he expected, according to the sales contract, to receive an irrevocable credit."

As explained in Chap. III, an American bank which has been asked to notify a beneficiary of a credit will never confirm it if revocable by the opener. In German practice, however, a revocable-confirmed credit is possible. This type of credit cannot be canceled by the issuing bank on its own initiative but only upon instruction from the opener. As a rule a bank is not required to send a beneficiary notice of an unconfirmed revocable credit, but confirmation necessitates the sending of such an advice, whether the credit is revocable or irrevocable by the opener.

On this subject a recent decision was rendered by a German court to the following effect:

"Whether a credit should be issued in a revocable or irrevocable form can be determined only from the agreement between the two

parties. It is the duty of the seller definitely to instruct the buyer in what form to establish the credit.

The establishment of a credit without any further explanation does not necessarily signify the issuing of an irrevocable credit for the establishment of an irrevocable credit requires according to the general practice a separate agreement. No importance is attached to the fact whether a credit is opened in favor of a seller by the buyer himself, or by a third party." Supplement of the *Berliner Boersen Courier*, No. 30, Jan. 18, 1922.

**IV. Forms of Letters of Credit.**—In order to illustrate the various types of letters of credit described above, the forms used by some of the leading German banks will be presented in their original text with an English translation. .

1. *Letter of Credit.*—As mentioned above, the letter of credit (Akkreditiv) is the communication addressed by the party opening the credit to the bank issuing the credit, and the instrument conforms closely to our application for a credit. A clean, irrevocable letter of credit reads as follows:

"Bar-Akkreditiv Nr. ...	"Clean Credit Number ...
Wir bitten Sie, der Firma .....	We request you .....
im Auftrage von.....	to pay to the firm of .....
M. ....	for account of .....
in Worten:.....	M. ....
unwiderruflich gültig bis .....	in words .....
auszuzahlen ....."	irrevocable until ....."

This form can be changed from a clean to a documentary credit by adding the expression:

"gegen Entgegennahme folgender Dokumente: ....."	"against delivery of the following documents: ....."
"welche Sie uns einsenden wollen"	"which please forward to us"

This form of credit may be rendered revocable by including the following statement:

"Der begünstigten Firma be- lieben Sie hiervon in unverbind- licher Förm Kenntnis zu geben und dabei ausdrücklich zu be- merken, dass es sich um einen	"Please give notice to the favored firm herein in a non-ob- ligatory communication and espe- cially call to its attention that this involves a revocable credit of
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unbestätigten Kredit handelt, which cancellation may follow at dessen Widerruf jederzeit erfolgen any time." kann."

2. *Acknowledgment to Opener.*—Whether the credit is clean or documentary, irrevocable or revocable, it is formally acknowledged by the bank to the opener in a communication which in the case of a documentary credit reads as follows:

"Wir sind im Besitze Ihres Schreibens vom ... mit welchem Sie uns beauftragen, nachstehende Dokumente ..... gegen Zahlung von M. .... zu Ihren Lasten aufzunehmen, worauf wir nach Einreichung derselben zurückkommen werden.

Wir bemerken ausdrücklich, dass wir für die Echtheit, Vollgültigkeit und Vollständigkeit der durch uns aufgenommenen Dokumente keine Gewähr übernehmen."

"We have at hand your letter of ..... in which you instruct us to receive the following documents ..... against payment of M. .... to be debited to your account, upon presentation of which we will further advise you.

We call to your special attention that we assume no responsibility for the validity, genuineness and sufficiency of the documents received by us."

3. *Advice by Issuer to Beneficiary.*—The beneficiary receives notice of the credit not from the opener but from the issuing bank or a second advising bank. If irrevocable, the advice assumes a form which reads as follows:

"Wir sind von ..... beauftragt, Ihnen wegen ..... gegen Aushändigung folgender Dokumente: ..... den Betrag von ..... M. .... zu vergüten und sehen der Einreichung der Dokumente entgegen. Wir bestätigen Ihnen hiermit, dass das vorstehende Akkreditiv bis zum ..... unwiderruflich ist."

"We have been instructed by .. .. to pay you for account of ..... against delivery of the following documents ..... the amount of ..... M. .... and await the presentation of documents. We state that the above letter of credit is irrevocable until ....."

As indicated above, a credit irrevocable by the opener is usually confirmed by the issuing bank and hence contains the expression found at the end of the above letter. If the credit

is revocable by the opener, it is usually unconfirmed by the issuing bank which then includes in its advice to the beneficiary the following expression:

“....Wir bemerken, dass vorstehendes Akkreditiv jederzeit widerruflich ist und dass obige Benachrichtigung an Sie ohne jede Verbindlichkeit für uns erfolgt.”

“We note that the foregoing credit is revocable at any time and that the above notification to you involves no obligation on our part.”

4. *Advice to Correspondent.*—At times the issuing bank is often requested to domicile the credit with a correspondent bank located near the beneficiary. The communication which the bank then addresses to the correspondent will read:

“Unbestätigter Kredit Nr. ....

Hierdurch bitten wir Sie, folgendes Akkreditiv zu eröffnen:

Betrag:

gültig:                      widerruflich

Begünstigter:

Unser Auftraggeber:

benutzbar gegen Einlieferung von:

Wir bitten Sie, die aufgenommenen Dokumente an ..... zu senden und die begünstigte Firma von der Eröffnung des Kredits in unverbindlicher Form für uns und unseren Auftraggeber zu benachrichtigen.”

“Unconfirmed Credit No. ....

Herewith we request you to open the following credit:

Amount:

valid until:                      revocable

Beneficiary:

Our Opener:

available against delivery of:

We request you to send the documents when presented to ..... and to notify the accredited firm of the opening of the credit in a non-obligatory form in behalf of ourselves and our openers.”

5. *Acknowledgment of Correspondent.*—If the correspondent accedes to the request for the opening of a credit, it will reply in the following form:

“Wir empfangen ..... Ihr Schreiben vom ..... mit dem Sie ..... bei uns bis zum Betrage von

M. .... gültig bis ..... akkreditieren.”

“We received ..... your communication in which you accredit ..... with us up to the amount of M. .... and available until .....”

6. *Advice by Correspondent to Beneficiary.*—The correspondent then informs the beneficiary in the following advice of the opening of the credit:

“Wir werden von .... brieflich/  
telegraphisch verständigt, dass  
genannte Bank einen Kreditbrief  
No. .... zu Ihren Gunsten

in Höhe von .....

unwiderruflich gültig bis ....  
widerruflich

ausgestellt hat, der unter Beifüg-  
ung folgender Dokumente .....  
benutzbar ist.

Wir sind beauftragt, Ihre auf  
Grund dieses Kredites zu ziehen-  
den Sicht-Tratten, zu negoziieren  
und bitten Sie, uns die vorbezeich-  
neten Dokumente einzureichen.”

“We are informed by ..... by  
letter/telegraph that the above  
mentioned bank has opened letter  
of credit number ..... in your  
favor

to the amount of .....

irrevocably  
revocably valid until .....

available against delivery of the  
following documents:

We are instructed on the basis  
of this credit to negotiate your  
sight drafts and request you to de-  
liver to us the above mentioned  
documents.”

V. *Liabilities of Parties under German Law.*—As in the case of American practice, litigation over German letters of credit arises mainly from the act of cancellation. In German practice, however, breaches of contract in recent times were made not so much by buyers of goods as by sellers, who were often ready to take advantage of the continually rising prices during the War and especially in the period immediately following the close of hostilities.

1. *Relation of Opener to Beneficiary.*—The contract of sale between buyer and seller frequently calls for a letter of credit and specifies such details as the name of the issuing bank and the time within which the credit is to be opened. If the contract of sale mentions a particular bank as issuer, the buyer of the goods must open the credit with this bank alone and not with any other institution. (*Bank Archiv*, Vol. XX, No. 17, March 15, 1921.) A buyer and seller entered into a sales contract in which the former agreed to open “an irrevocable credit to the amount of 85,000 marks at Bank D, credit to expire on Dec. 31.” The buyer did not open the credit directly with Bank D but indirectly through Bank M. The latter notified Bank D that a credit had been opened in its favor for the benefit

of the seller and that payment would be made upon presentation of the proper documents. However, this indirect credit proved unsatisfactory to the seller, who canceled the order. The buyer believed that he had complied with the terms of the contract and sued the seller for damages. The court gave judgment to the seller in a decision which read in part as follows:

“Where delivery against an irrevocable credit at a specified bank has been agreed upon, the buyer does not meet his obligation by placing the amount for the disposition of the specified bank with another bank.” (*Bürgerliches Gesetzbuch*, Civil Law Code, par. 326.)

A sales contract usually specifies the period of time within which a credit must be opened by the buyer. If he fails to open the credit within this time, the seller may withdraw from the contract of sale and sue the buyer for damages. A German buyer had agreed to open a credit immediately by cable with a bank in Copenhagen in favor of a Danish seller. He refused to ship the commodities because the credit was opened not immediately upon the signing of the contract but five days later. The two parties sued for damages, but the courts rejected the claims of both. The plea of the buyer was denied because he had broken the contract by opening the credit after five days when no more than two days were needed for such a transaction, while the seller forfeited his claim to damages because he had withdrawn from the contract.

In a somewhat similar case a buyer was informed on Oct. 16 by a seller that the latter had five carloads of certain goods which would be delivered at a fixed price, “payment to be made in advance by cable through direct irrevocable credit on the National Bank, Berlin.” On the same day the plaintiff accepted the offer and instructed a local bank to open a credit in favor of the seller with the Berlin Bank. But this bank did not advise the credit until Nov. 5, to the beneficiary, who regarded this delay as a breach of the contract of sale and sold the goods elsewhere. The opener of the credit brought suit for damages but the courts gave judgment to the beneficiary. From this decision it may be concluded that it is not sufficient for the buyer merely to induce a bank to open a credit in time, but the credit must be actually opened and the beneficiary immediately notified.

*Berliner Boersen Courier*, No. 284 R. II 565/20-22.4.21. See decision of Z. S., April 16, 1918, R. II, 505/17).

2. *Relation of Opener to Issuer*.—When an opener of a credit has requested a bank to notify another institution of the establishment of the credit, the notification must be made within the time limit and in no case later than within business hours of the last day. If the credit is notified after business hours of the last day, the German courts have held that this delay entitles the seller to withdraw from the contract and the buyer in turn to sue the bank. (R.G. Zivilsenat, Feb. 12, 1918, R. II 420/17.)

A bank must exercise due care in handling the shipping documents accompanying drafts drawn under its letter of credit. German law, the same as American and British, does not hold a bank liable to the opener for the validity of the documents or the genuineness of the goods. In a certain case, the bill of lading originally called for one bag of seed weighing 10 kilograms, but this amount was raised to 140 bags holding 12,350 kilograms. The bank, having no means of ascertaining that the bill of lading had been altered in amount, paid the beneficiary in accordance with the instructions of the credit opener. The latter sued for damages but the court decided against his claim on the following ground:

“The opener of a credit carries the risk of any falsification of documents which may arise, provided that the falsification could not be detected by the paying bank in exercising a degree of care customary in handling such transactions.” (3 Z.S., O.L.G. Stuttgart, December, 1920, II 547/20.)

3. *Relation of Issuer to Notifier*.—A bank notifying a credit must carefully observe the instructions of the issuer, and can be held liable for any acts of remission on its part. This view was held by the court in a case where the issuing bank had asked a correspondent to pay a beneficiary against delivery of a railroad bill of lading addressed to a party in a certain city. The beneficiary received payment although he presented a bill of lading which consigned the goods to the wrong destination where the goods remained uncalled for. The credit-issuing bank refused to reimburse the negotiating bank on the ground that the instructions had not been followed by the latter institution. It brought

suit but was not upheld by the court which decided that the plaintiff had not exercised the care necessary in handling the documents.

4. *Relation of Issuer to Beneficiary.*—Whether a letter of credit is irrevocable or revocable, the issuing bank has no right of recourse on the beneficiary if his documents are in order and if his drafts have been honored. A beneficiary is not obliged to find out for himself whether a letter of credit has been opened in his favor (Decision of the R.G. of April 26, 1921, 377/20). In one case the defendant sold the plaintiff a cargo of goods on a letter of credit of the Leipzig Bank against delivery of a copy of the railroad bill of lading. According to the sales contract the seller was permitted to withdraw in case of non-fulfillment of the conditions of payment on part of the buyer. The seller was notified by the buyer that he had opened a letter of credit with the Leipzig Bank in favor of the former, but the bank delayed in notifying the seller who received the advice only several days thereafter. Taking advantage of the contract of sale, which stipulated that notice of the credit should be given by the bank and not by the opener, the seller refused to deliver the merchandise. His action was upheld by the court which expressed the opinion that the opener of the credit had redress not against the beneficiary but against the bank which delayed in transmitting the letter of credit (B.G.B., par. 278).

## CHAPTER XIII

### COMMERCIAL CREDIT PRACTICE OF JAPANESE BANKS

**I. Introduction—Development of Japanese Exchange Banks.**—The following study is based on an article by the author in the *Federal Reserve Bulletin*, for March, 1922, pp. 296-300, and presents a survey of the commercial credit practice of Japanese banks. This survey should be of interest because of the importance of Japanese-American trade relations. From one-fourth to one-third of the total foreign trade of Japan is conducted with the United States which is Japan's best customer. The development of the banking system for financing this trade has passed through a rapid evolution. In the early history of Japan's commerce it was financed almost entirely by branches and agencies of British, European, and later American banks. A small part of this trade was financed by some of the old private firms of Japan which had been engaged for several centuries both in banking and in merchandising.

The next period in the evolution of Japanese banking was initiated by the founding of local exchange banks. They were ordinary commercial banks engaged both in domestic and foreign business and operated under either a special or general charter. An example of the former is the Yokohama Specie Bank which was organized in 1880 under a special imperial charter for the purpose of stabilizing the currency of Japan and for facilitating its foreign trade. Some of these special chartered institutions were given definite territories for their activities, as, for example, the Bank of Taiwan which was formed to develop the resources of Formosa and the trade with South China and the South Sea Islands, and the Bank of Chosen recently established to expand Japan's trade in Korea (Chosen) and in Manchuria. In addition, a number of the old private banks were incorporated under the general chartering act of the Imperial Government. Although the two types of banks, special and general chartered, differ as to form of incorporation, their

operations are practically the same in nature. These native organizations soon entered into active competition with the branches of foreign banks, and in time the former took over the financing of the greater part of the exports from Japan, while the latter were able to retain control over the handling of the country's imports. This division of the field proved favorable to the Japanese banks which accumulated gold balances abroad, while foreign banks which held silver balances in Japan endured heavy losses due to the fall in the price of silver. With the beginning of the century, the Japanese banks established their own branches in foreign money centers and so were in a position to handle imports to Japan as well as exports.

The latest stage in the financing of Japanese foreign trade came with the outbreak of the War in 1914. The branches of German banks were eliminated entirely, and even the British agencies were forced to restrict their credit activities. On the other hand, American banks increased in relative importance, and the Japanese exchange banks were likewise able enormously to augment their business. The former increased the number of their branches in Japan, while the latter established new agencies in the United States, especially in New York, San Francisco, and Seattle. Because of this expanded American and Japanese bank organization and the dislocation of the British money market, the dollar and yen exchange to a large extent replaced sterling as a means of settling balances between the United States and Japan. Formerly the method of paying for exports from Japan was almost entirely through London, but in the past few years direct exchange relations have been established. This movement has been accelerated by the growth of an acceptance market in both Yokohama and New York. The period since 1914 has also been marked by a change in the technique of financing Japanese imports. For years they were financed largely by the authority to purchase and by trade drafts, but these methods have given way to the use of the letter of credit and bankers' bills.

Consideration will therefore be given mainly to the operation of Japanese letters of credit. This study does not present many varied or new technicalities. Japanese commercial credit practice is quite uniform because the financing of foreign trade has been controlled by a small number of banks located in Yoko-

hama, Tokyo, Kobe, and Osaka. The practice of these institutions to a large extent has been modeled after the usage of British and American banks, and so attention need be given only to those phases which are peculiar to Japanese operations.

**II. Letter of Credit.** 1. *Opening of credit.*—A Japanese bank in issuing a letter of credit may base its action merely on the credit standing of the importer or may require him to deposit some form of collateral. When the Japanese applicant is of uncertain credit standing or is not in a position to furnish collateral, he may still be able to obtain a credit by inducing another party to act as his guarantor. The latter binds himself to reimburse the bank for all its advances if the opener fails to meet his obligations. This form of personally indorsed credit, while quite common in Japan and in fact throughout the entire Far East, is not extensively used in the United States or Great Britain. Japanese banks usually require openers of credits to present formal applications and also to sign regular contracts, which are quite similar in content to the forms employed by American banks. A rather peculiar Japanese form is presented below:

I/We shall feel obliged by your forwarding instructions by cable/letter to your agents in ..... to make payment or payments as follows:

To M. ....

Any sum or sums not exceeding in all ..... say .....

Against a draft or drafts at ..... days' sight drawn by the said firm upon the X Bank, Ltd., ....., for my/our account.

Against a shipment or shipments of .....

Not later than ....., the drafts to be accompanied by a full set of shipping documents relating to the above-mentioned merchandise ordered by me/us, viz:

Invoices .....

Bills of lading .....

Policies of insurance .....

In consideration of your granting me/us the above request, I/we hereby agree and engage to accept a draft or drafts at usance of ..... days' sight drawn on me/us by your bank in reimbursement for the amount so paid by your agents, and duly to pay the amount at maturity at exchange of ..... plus interest thereon at the rate of ..... per cent per annum, and also I/we undertake to hold myself/ourselves liable to you as per conditions set forth in the letter of guarantee signed by me/us.

This application calls for an instrument which is somewhat different from the ordinary letter of credit. It is used only between the home office of a bank and its foreign agency, which is instructed to pay the beneficiary cash for his documents, and the home office obtains reimbursement by drawing an interest-bearing draft on the importer.

Because of distance, a Japanese bank in issuing a letter of credit to a foreign seller, say in New York, may first send him a cablegram or permit him to effect his negotiation before the arrival of the letter itself. He is then instructed to note on his draft "Drawn under letter of credit en route."

2. *Issuing of Letter of Credit.*—Japanese banks seldom issue their letters of credits to the beneficiaries directly, but instead notify them either through agents or correspondents. As mentioned above, Japanese banks operate a considerable number of agencies in the more important commercial centers throughout of the world, and elsewhere maintain a network of correspondents. When they are asked to advise a credit of a Japanese bank, the question of confirmation naturally arises. The distinction between irrevocable and confirmed credits is not sharply drawn by Japanese banks. One bank, in answering a letter addressed by the author for the Division of Analysis and Research regarding confirmation, states that if requested by a foreign bank to notify a Japanese beneficiary of the opening of an irrevocable credit, it would be inclined to add its confirmation unless instructed to the contrary. Another bank clearly differentiates between these two types of credits, as evidenced by its answer which reads as follows: "When an American bank issues an irrevocable letter of credit and does not request the Japanese bank to confirm the same, it is an irrevocable unconfirmed letter of credit; therefore an irrevocable credit is not always confirmed by the Japanese bank." As a matter of actual practice, American banks issuing their irrevocable credits in favor of Japanese exporters generally expect Japanese banks merely to notify the beneficiaries and not to add their confirmation. On the other hand, in the financing of an importation to Japan, the beneficiary abroad receives a credit from the local agent and not from the home office of the Japanese bank, and so the credit is either revocable or irrevocable by the agency without involving any act of confirmation. It is therefore essential for American im-

porters and bankers carefully to specify whether credits should be advised by Japanese banks as confirmed or unconfirmed by them.

On the subject of cancellation, Japanese banks generally hold that they have the right to rescind a revocable unconfirmed advice at any time without the necessity of giving notice of their action to the beneficiary. The revocable unconfirmed advice of one Japanese bank to the beneficiary contains the statement, "We have no authority from our correspondents to confirm this credit. The credit is therefore subject to cancellation with or without notice and the above particulars are for your guidance only." Another bank explains its policy as follows: "We have the understanding that the validity of such revocation starts at any time that we receive such instruction, without notice to the beneficiary." The same institution adds the following comment: "In case of an unconfirmed revocable credit, i. e., unconfirmed with 'subject to cancellation' clause, we act only as advising agents and have no right to revoke the credit unless we receive instructions from the issuing bank to this effect."

3. *Transferring of Credit.*—Japanese banks do not usually permit a beneficiary to transfer his credit to another party. The right of assignment is, however, recognized by a few banks which insert in a form drawn especially for this purpose the expression that the credit is available by the accreditée "or to any nominee or nominees appointed by him in writing." As explained in Chap. III on classes of letters of credit, some banks in the United States make it a practice, at the request of the beneficiary of a credit, to issue an ancillary instrument in favor of a second party who is supplying or manufacturing the merchandise. This practice is not followed by Japanese banks, which, if necessary, prefer to cancel the original credit and to open a new credit.

4. *Presenting of Documents.*—Japanese banks naturally will accept documents only when they are drawn in conformity with the term specified in the letter of credit. When these conditions are not stipulated, the procedure of handling shipping documents in a general way is governed by the same principles of commercial usage which apply in the United States. Japanese bills of lading must conform to an imperial statute, which is similar in content to the Harter Act of the United States. The

“received for shipment” instrument is not regarded as a bill of lading in Japan. Some banks will accept only on-board bills of lading, while others follow the rule of compelling beneficiaries to furnish on-board bills of lading unless instructed to accept “received-for-shipment” bills. This policy is the inverse of American usage, which recognizes the right of an American bank to accept a “received-for-shipment” bill of lading unless advised to the contrary. Japanese banks do not discriminate against the offering of certificates of insurance under blanket policies and do not insist upon the production of the policies themselves. However, brokers’ cover notes are not regarded as satisfactory. The remaining documents of the commercial set are similar in nature to those which are used in the United States.

Japanese bankers are usually unwilling to permit a beneficiary to present documents covering merely a partial and not a complete shipment. On this subject one bank writes:

When the terms of the letter of credit include the quantity of the goods ordered, we do not negotiate drafts accompanied by documents which represent partial or separate shipments, unless we receive specific authority to this effect from the issuing bank. We do, however, negotiate them when there is no mention of the quantity in the letter of credit and also when there is no such stipulation against this action by the issuing bank.

5. *Negotiation of Drafts.*—As mentioned above, Japanese banks issue most of their credits through their agents or correspondents. Upon notification by an agent, the beneficiary of such a credit is not usually allowed to sell his drafts to banks at large, but is bound to confine his negotiation with the advising bank only. Accordingly, the Japanese issuing bank usually gives the notifying bank the following instruction: “Kindly advise the beneficiary of the above credit and also of the condition that this credit shall be valid only when the drafts are negotiated through your bank.” Japanese credits, if notified by agents, may therefore be described as special rather than general.

Most Japanese banks do not claim the right of recourse to the beneficiary on drafts which he has drawn under letters of credit, whether revocable or irrevocable. The general policy of Japanese banks is well stated by one institution which writes as follows:

An issuing bank has not the right of recourse to the beneficiary of a letter irrespective of "irrevocable" or "revocable," unless especially stipulated to that effect in the credit. If there is no mention in the letter of credit, only the bona fide negotiator of the draft, excluding the issuing bank and the confirming bank, has the right of recourse to the drawer.

6. *Expiration of Credit.*—Japanese banks quite naturally refuse to honor documents which are presented after the date of expiration of the credit. The question was raised by the Division of Analysis and Research as to the policy which a bank would follow if the Japanese beneficiary presented before the date of expiration documents which were unacceptable and which were again presented in corrected form after the termination of his credit. To this question all banks replied that the beneficiary was not entitled to payment under these conditions. Letters of credit frequently contain an expression calling for "prompt shipment." Japanese banks in their answers express a dislike for this statement because of its indefiniteness. They interpret the length of time within which the exporter must make shipment under such a credit variously from one week to ten days.

7. *Reimbursement of Credit.*—Reimbursement between notifier and issuer is effected by the former debiting the account of the latter, or drawing drafts on the latter. The issuing bank in turn may obtain cash from the opener who is importing the goods or may draw a draft on him. This bill he has agreed to accept according to the terms of his application, which also specifies the rate of interest to be paid.

III. *Authority to Purchase.*—Transactions in foreign trade may be financed by the importer or by his bank either through the letter of credit or the authority to purchase. The general features of this instrument have been explained in Chap. VIII, and so only the characteristics peculiar to Japanese practice will be described. As explained above, the letter of credit has to some extent replaced the authority to purchase as an instrument for financing imports to Japan from the more advanced commercial nations, such as the United States, Great Britain, and Europe. However, the authority to purchase still remains an instrument of primary importance for facilitating Japanese commerce with other eastern countries, such as China, India, and the Philippine

Islands. The authority to purchase or letter of instruction, as it is known in Japan, gives rise to a trade bill drawn by the exporter on the Japanese importer, and is purchased by a bank acting upon the instructions of the importer. The buyer and seller in the contract of sale usually determine the form of the authority which in most cases is revocable rather than irrevocable. Also the drafts are made with recourse on the drawer and so the authority to purchase is a less desirable instrument than the letter of credit from the standpoint of the exporter. Acting in accordance with the contract of sale the Japanese importer requests his bank to authorize the purchase of the exporter's draft by an agent located near the latter. The application of the exporter to his bank may read as follows:

No. ....

.....19...

To the X BANK.

DEAR SIR: I/We request you to forward instructions by mail/cable to your ..... branch/agency to purchase draft or drafts as follows:

Drawn by .....

Upon .....

Against shipment of .....

At usance of .....

To be drawn in ..... (payable at the bank's drawing rate for demand drafts on .....).

Not later than .....

To the extent of ..... say .....

accompanied by a full set of shipping documents, viz: bills of lading, invoices, and policies of marine insurance relating to the above-mentioned merchandise ordered by me/us, it being understood that you will take the invoice as genuine and reliable evidence.

In consideration of your granting me/us the above request I/we hereby engage to accept and duly pay the draft or drafts drawn as above said, and guarantee that I/we shall not cause you any loss or losses in consequence of such shipment or shipments being delayed or the goods turning out on arrival to be of defective quality, or under any circumstances whatever irrespective of the goods.

The bank in turn acknowledges the receipt of the application and signifies its approval in the following form:

DEAR SIR: In accordance with your application No. .... of ..... we shall have the pleasure of instructing our ..... branch/agency

to negotiate the drafts drawn by ..... on your good/self/selves if offered before ....., 19.....

We reserve to ourselves the option of canceling at any time if deemed expedient in the interest of the parties concerned.

Yours faithfully,

For the X Bank,

.....

In issuing authorities to purchase the Japanese bank is careful to relieve itself of all the commercial risks attendant upon the shipping of goods in foreign trade, as indicated in the expressions found in the above forms. Responsibility is waived especially as to the genuineness of the merchandise and the validity of the underlying documents. It may also be observed that in its acknowledgment the bank reserves for itself the right to cancel the authority at will.

**IV. Trust Receipt.**—In extending its credit on an export or import transaction a bank is usually covered by the merchandise which serves as collateral. However, at some stage in the movement of the goods to market, it is often necessary for the bank to surrender its control over the goods or documents and under these conditions it makes use of the trust receipt. In Japanese practice this instrument is better known as a letter of guarantee, or following British usage as a letter of lien. The trust receipt may be used in connection with the financing of a foreign trade transaction either by the importer or by the exporter. As mentioned above, the former's bank may extend the credit either through the authority to purchase or the letter of credit. When goods imported under an authority to purchase arrive in Japan the documents may be released to the importer under a trust receipt which may read as follows:

To the MANAGER, THE X BANK, LTD.

DEAR SIR: In consideration of your having this day delivered to me/us the following documents, viz:

Bills of lading (marks and numbers of packages, etc., as on the back hereof) which you hold as collateral security for the due payment of the draft, ....., amounting to ....., drawn upon me/us by M. ...., of ....., and accepted by me/us, I/we hereby undertake to land and store on your behalf the goods covered by the said bills of lading in ..... godown on lot No. ...., holding them strictly under lien to you, and keep them fully insured on your behalf against fire, to the

extent of the acceptance, payable, in case of loss, to you with understanding that any expenses incurred on these goods shall be borne by me/us and not chargeable to you.

I/We also hold myself/ourselves responsible for any damage or loss caused to the said goods and not covered by fire insurance policy, during the time so stored in my/our godown.

I/We also engage to hand you the proceeds of portion of the goods on delivery before maturity of the bills, and also to return undelivered goods to you, should you so desire at any time.

There is no need to reproduce the trust receipt issued in connection with a letter of credit, for the form is similar in content to those forms analyzed in Chap. IX. The burden of furnishing credit to a transaction in international commerce may be carried by the exporter or by his bank which permits him under Japanese practice to make an overdraft on the bank—a usage not general in the United States but common in Europe. The bank agrees to honor a demand draft which therefore becomes a check. The bank is secured by the merchandise which is kept in a warehouse or “godown,” as it is called in the Far East. When the exporter is ready to make shipment he is given the godown receipt upon signing an agreement or letter of lien which reads as follows:

And in consideration of your allowing me/us to overdraw my/our account (export account) with you by my/our cheque or cheques, against the above contract, I/we hereby agree that such cheque or cheques shall be drawn only for payment of merchandise purchased by me/us for shipment as well as for freight, insurance, and other shipping charges on the said merchandise and that cheques shall be made out only in favor of a party to whom actual cash payment is due. I/we also hereby agree to convey the ownership of the merchandise to your bank, keeping them in my/our godown separate and distinct from other goods and open to your inspection at any time, either alone or jointly with other interested banks, until shipment when bills and shipping documents shall be completely delivered to you, in compliance with the terms of the above contract.

I/We further guarantee that the goods held by me/us under the present agreement shall be fully insured against loss or damage by fire at my/our expense until delivered to the steamship company. The amount insured must be paid in case of fire direct to your bank.

It is understood that interest shall be charged on the daily maximum

balance of my/our overdraft at a rate to be notified by you from time to time.

Letters of lien are employed by Japanese banks in surrendering shipping documents to importers so as to enable them to enter their goods at the customhouse, and later to store them in godowns. As mentioned in the chapter on trust receipts, American banks usually insist that the importer place the merchandise in a warehouse over which he has no control. However, in this respect Japanese banks are not so particular, as customers are permitted to store goods in their own warehouses, but the goods must be segregated and available for inspection at any time by the bank or its agents. The Japanese bank endeavors to protect its interests by insisting upon a satisfactory insurance coverage. The Japanese trust receipt serves mainly as a means of enabling the importer to store goods in godowns, but is seldom used to permit him to sell the goods. These are released for the purpose of sale only if the importer has a very good credit standing, or if he is able to induce a second party, either a merchant or a banker, to act as his guarantor. Japanese banks seldom surrender goods to the importer on trust receipts for the purpose of manufacture. In general, the trust receipt although widely employed in Japan does not rest on a very firm legal basis.

## CHAPTER XIV

### COMMERCIAL CREDIT PRACTICE OF SOME CONTINENTAL BANKS

This chapter is adapted from an article by the author in the *Federal Reserve Bulletin*, for April, 1922 (pp. 410-14), and analyzes the practice of some leading banks of Belgium, Holland, and Italy. Their practice has many features in common, and does not present characteristics which vary greatly from those followed by institutions in the United States or in the countries which have already been considered. Close attention need therefore be given only to those phases which depart from the usage as accepted by American bankers and merchants. The following review is not an analysis of the practice of all banks in the respective countries, but is rather a study of the methods of leading institutions. It represents, however, the accepted practice in each country, since the financing of foreign trade is concentrated in the hands of relatively few institutions.

**I. Opening of Credits.**—As in American practice, the importer addresses his application for a credit to the bank on a form prepared by the latter. The content is similar to the forms used by American institutions. A large Dutch bank has the applicant fill out a form which begins with the statement: "We request you to open the following credit which please advise to the beneficiaries." The application required by a Belgian bank reads: "We herewith request you to open a credit," and adds, "with your correspondents at ..... according to the practice of that place." This statement may be deleted by the applicant, according to whether he wishes the credit issued direct by the Belgian bank or through a foreign correspondent. The application of the Belgian bank contains many expressions to be found in the contracts for credits used by American banks. For example, the application makes provision for reimbursement in the following expression: "Will you please debit our account for your payments effected or acceptances made against this credit," and concludes with the state-

ment, "It is understood that you will incur no responsibility for the authenticity of documents which will be delivered to you, or for the quantity or quality of the underlying merchandise."

If the importer's application is approved by the bank, it then sends him a formal acknowledgment. This communication serves not alone as an approval of the importer's application, but also as a statement of the conditions under which the bank is willing to issue its letter of credit. The form used by one Belgian bank reads as follows:

DEAR SIRs: We have received your letter/telegram of ..... opening a credit with us in favor of ..... for account of ..... We acknowledge it and take liberty at this occasion to call your attention to the following points:

We always notify beneficiaries of credits opened in their favor. In case of revocable unconfirmed credits, this notification is given as a simple advice without any engagement on our part.

A credit is not opened as irrevocable confirmed unless upon special instruction, and under the entire responsibility of the opener, or remitter of order. In this case an expiration date must be stated. Such a credit can not be modified or canceled without consent of the beneficiary.

We always examine with great care the documents which are delivered to us. We, however, decline all responsibility as to their authenticity or the quality and quantity of merchandise therein mentioned.

The documents are forwarded at your risk. It is understood that you engage yourselves to take them up upon notice of their arrival against covering of our payments, outlays, commissions, freight, and interest.

The forms employed by Dutch and Italian banks are similar in nature and are therefore not reproduced. Because of the details thus inserted in both application and acknowledgment, there is little need for the formal contract which American banks usually require their customers to sign. Besides, Belgian banks feel that they are sufficiently well protected against fraud on the part of their customers through the provisions of Articles I and II of the Belgian law of May 5, 1872, which gives a creditor complete title to goods imported under a letter of credit.

**II. Issuing of Credits.**—A bank may issue a credit in three ways. It may deliver the letter to the importer, who in turn transmits it to the beneficiary, or the bank may forward this

communication direct to the exporter. A third method is to request another institution to inform the beneficiary of the establishment of the credit. It is not the practice of the banks in the countries under consideration to employ the first method, but there is no uniformity as to which of the other two methods should be followed. One Belgian bank prefers to issue its own letter direct to the beneficiary, while the Dutch and Italian banks employ the services of correspondents who notify the accredited parties.

Continental banks are often unwilling to negotiate drafts under letters of credit which have been advised by cable to the beneficiaries, since they thus have the opportunity of selling their drafts to more than one bank. If the issuing bank insists upon notifying its credit by cable to the beneficiary, it must advise this fact to the European bank which is to negotiate the drafts. When a credit is thus issued by one bank and advised by a second institution, the question arises as to where the credit is domiciled. In order to obtain the views of foreign banks on this subject, they were given the following question: "If an American bank asked you to advise a beneficiary that it had opened a credit, would you advise the beneficiary that (*a*) the American bank had opened such a credit, or (*b*) you had opened the credit." On this subject there are two different views. One holds that the credit is domiciled with the issuing bank, while on the other hand it is maintained that the credit is established with the advising bank. To the above question a Belgian bank answered as follows: "Our letters of advice indicate that the credit is opened by us." A different view is held by the Italian banks, one of which replies: "We inform the beneficiary that the American bank has opened such a credit."

**III. Confirming of Credits.**—As explained in Chap. XII on German commercial credit practice, continental banks use the terms "revocable" and "irrevocable" in referring to the right of the opener to cancel the credit. The words "unconfirmed" and "confirmed" are applied to the banks whether they are issuing the credits or merely advising them. This view is also held by the foreign banks under consideration, and from their answers it is apparent that they draw no practical distinction between the terms "irrevocable" and "confirmed." In fact, one institution makes the following representative answer: "We con-

sider the terms 'irrevocable' and 'confirmed' synonymous, assuming that there is practically no difference between the liability incurred by a bank not to revoke a credit before a given time (irrevocable credit) and that incurred by confirming to a beneficiary the promise that payment will be made before the expiration of a stipulated date (confirmed credit)."

It is generally assumed by continental banks that they are not legally bound to notify beneficiaries of the opening of unconfirmed credits, but as a matter of practice such notifications are usually given. Confirmed credits, however, must be notified to the accredited parties.

These views concerning unconfirmed and confirmed credits find expression in the forms used by the various banks. A Belgian bank inserts in its application which the opener fills out the following expression: "You are directed to notify the beneficiaries of the opening of the credit by giving them *a simple advice without engagement on your part*/your confirmation for our account and responsibility." The opener then deletes one expression or the other, depending upon whether he desires the opening of an unconfirmed or confirmed credit. If he applies for the former, the bank then addresses to the beneficiary a communication which is headed: "Revocable unconfirmed credit," and which concludes with the following statement: "The foregoing is only a mere advice revocable at any time and does not constitute any engagement on our part." If, on the other hand, the bank is requested to issue a confirmed credit its letter is captioned "Irrevocable confirmed credit," and closes with the statement: "This credit will remain in force until...." Analysis of the forms of Dutch banks indicates the same practice as stated above. One Dutch bank in its acknowledgment to the opener writes—

"If we are without your instructions to open an irrevocable credit we shall advise the beneficiaries without any liability on our part. . . . In case you wish to confirm the credit to the beneficiaries we shall be pleased to receive your special instructions to that effect, together with your statement for what period the credit will be irrevocably valid."

In accordance with the instructions of the opener the Dutch bank will then issue its letter, which if unconfirmed contains the following statement:

"You will kindly note that this advice is given by us only to simplify the transaction and that it may not be considered as a confirmation of the credit—it involves no liability for us. In case you would not be in a position to adhere to the above stipulations, we suggest that you apply to your buyers, so that they have the instructions altered."

However, if the opener desires that the bank add its confirmation, the communication to the opener then reads:

"We beg to inform you that there has been opened with us a confirmed credit irrevocably valid until ....."

As mentioned above, revocable credits are likewise unconfirmed by the banks, who are therefore free to exercise the right of cancellation. The question then arises, may such credits be revoked without giving the beneficiary notice of this action? Banks are unanimous in their opinion that notice is not required. It will be recalled that in the case of *Cape Asbestos Co. vs Lloyds Bank* (Kings Bench, July 24, 1921; see p. 141), the court held the view that a bank was not obliged to inform the beneficiary of an unconfirmed credit that it had been canceled. Although the European banks hold the same view that they were not compelled to give notification of the cancellation, as a matter of practice it is usually sent to the accredittee. There is, however, no agreement as to the exact time when an unconfirmed credit expires. It is quite generally held that this type of credit terminates as soon as the bank receives the order of cancellation from the opener, and so it may be concluded that the credit can be revoked at any time before the honoring of the draft drawn by the beneficiary. Irrevocable confirmed credits contain a date of expiration before which cancellation can not be made. The period within which the credit is effective is termed by European banks as the "validity of the credit."

The question of the revocation of a credit is more or less erroneously associated with the matter of recourse. It is commonly held that unconfirmed credits by implication call for the drawing of drafts with recourse, while confirmed credits permit the drawing of bills without recourse. These views are not accepted by continental banks, but instead they hold that, if the beneficiary is permitted to draw a sight draft on a bank, it no longer has recourse to him regardless of whether the credit is con-

firmed or unconfirmed. This conclusion assumes that there is no mention of recourse in the credit, and also that the documents submitted by the beneficiary have been drawn in strict compliance with the terms of the credit. If the documents are later rejected because of discrepancies, the bank has redress to the beneficiary of the credit whether it is confirmed or unconfirmed.

The analysis has so far assumed that the credit is available only by the beneficiary. In the case of credits covering goods imported into Europe, continental banks will make payment only to the specified beneficiary, unless the openers give instructions to the contrary. On the other hand, wider latitude is allowed in export credits which are frequently drawn in the name of a beneficiary or his order. One bank writes that in the case of import credits "this is a matter for the American bankers, or the foreign buyers who may open the credits to order. With export credits, however, transfer is generally allowed."

**IV. Presenting of Documents.**—After the bank has issued its letter, the next stage in the operation of the credit is the presentation of the documents by the beneficiary. He must naturally draw his drafts and submit his documents before a stipulated time. This may be stated as a fixed date of maturity or may be determined by the time of shipment as evidenced in the bill of lading. There is a difference of opinion as to the place at which a credit expires. It is the common view that where a credit calls for the presentation of documents before a certain date, this implies presentation at the office of the bank negotiating the drafts. However, certain Italian banks interpret this expression to mean that the documents must be delivered before the specified date to the bank which has issued the credit (i. e., in the country where the credit originates). Banks holding this view are probably influenced by their customers who are importing goods and who desire definite assurance that they will be in possession of the goods before a certain time. However, the adoption of this policy would impose upon negotiating banks the necessity of practically guaranteeing actual delivery of documents to the beneficiary. This matter becomes even more complicated when the drafts are accepted by a third institution. For example, an Italian bank may issue a sterling letter of credit, and an American bank on the strength of this document may negotiate the drafts which

in turn are drawn on a British bank. In order to avoid equivocation, it is therefore essential to state definitely where presentation of documents must be made.

Letters of credit often contain no fixed date of expiration, but instead the beneficiary is authorized to draw his drafts upon making "prompt shipment" of goods. This expression is interpreted by Belgian banks to mean that the beneficiary may deliver his documents at any time within 30 days of the advice of the credit. Some Italian banks adopt the same policy, although others allow the beneficiary only 15 days or even only one week if shipment is to be made by railroad. Regarding Dutch practice, no fixed rule can be stated, since it depends largely upon the custom of each port and upon the nature of the commodity being shipped.

Partial shipments are not regarded with favor by continental banks. They generally insist that the beneficiary effect complete shipment unless the opener gives instructions to the contrary. These are provided for in the application of a Belgian bank, which allows the opener to choose between "single shipment prohibiting entirely partial shipment" or "several shipments." Some Italian banks permit partial shipment in transactions involving staple commodities shipped in bulk or merchandise of which the price is definitely ascertained. Also subject to interpretation are the terms "about" and "approximately" when used in referring to the amount of the credit. Continental banks object to the use of these terms, but whenever they appear in credits they are interpreted to give beneficiaries a margin of from 5 to 10 per cent of the amount mentioned in the credit.

The various facts concerning the shipment are evidenced in the documents of the commercial set. The decision of the British court in *Diamond Alkali Export Corp. vs Bourgeois* (see p. 229) has raised several questions concerning the acceptability of certain commercial documents under a c.i.f. (cost, insurance, and freight) contract. This decision held that shippers under such a contract must present "on-board" bills of lading, since "received-for-shipment" instruments were not considered as acceptable. This decision is in accordance with the custom of most continental countries, where "on-board" bills of lading are used to a large extent and where banks accept "received-for-shipment" bills of lading only upon specific in-

structions to this effect from the openers of the credits. An exception to this rule is found in the case of a Dutch bank, which replied that it made a practice of accepting "received-for-shipment" bills of lading. The same policy is followed generally by German banks.

The court, in the above-mentioned case, also rejected certificates issued under blanket insurance policies and insisted that exporters deliver full policies. However, policies are not required by continental banks, although they naturally express a preference for policies as against certificates. Continental banks in issuing their credits refuse to assume the commercial risks involved in the shipment of goods. The banks waive all such responsibilities, and a Dutch bank defines its position to the beneficiary in a communication containing the following expression:

"We beg to call your attention to the fact that in taking up documents which are presented for payment in virtue of credits opened, we always exercise great care in examining them as to their being in due form and regular in every respect. However, we desire it to be thoroughly understood that we assume no responsibility for the genuineness of the documents, nor for the quantity or quality of the merchandise mentioned therein."

In acting as negotiators of drafts drawn under letters of credit, European banks refuse to accept responsibility for documents which deviate in any respect from the terms of the credit. Banks may negotiate the drafts if the documents contain technical discrepancies, but they will insist, as do American banks, that the beneficiary sign a guaranty, which, as issued by one bank, reads as follows:

We guarantee to indemnify you for any prejudice which might arise from the fact that your payment has been effected in deviation from the conditions of the above-mentioned credit, opened by your good selves; we engage ourselves to reimburse you for the above amount on the first application, against delivery of the documents we surrendered, in case your correspondents do not agree to your payment with regard to the relative deviations.

**V. Paying for Credits.**—With the accepting of the documents presented by the beneficiary thus explained, attention is once more directed to the relations between the bank and the in-

dividual opener of the credit. Under normal conditions the documents will arrive before the goods. But when the reverse takes place it is then the practice of continental banks to give a guaranty to the customs officials and steamship agents, so as to enable the importer to obtain possession of the goods without having presented the documents. At this stage in the transaction the importer may reimburse the bank if it has paid sight drafts drawn by the exporter, by paying cash or by having the bank debit his account. However, such transactions are largely financed by acceptance credits giving rise to the drawing of time drafts on the bank which accepts the bills and agrees to honor them at maturity. The accepting bank may adopt two policies regarding reimbursement. It may immediately call upon the opener for reimbursement or wait until a few days before the maturity of the drafts. On this subject banks have expressed the following opinion:

We act differently, according to the client and to the amount. Upon favorable appraisal of both these points, we deliver the documents and wait for payment at maturity. Otherwise goods are not released to the importer but remain in our trustees' hands, and the proceeds of sale are placed in a funded account in order to utilize the said funds at maturity to meet the accepted drafts.—(Italian bank.)

It sometimes occurs that an importer covers a draft accepted by us before maturity. In such a case, interest is refunded to the importer which agrees with the interest we are able to make on money deposited with us up to the date of maturity.—(Dutch bank.)

We consent to wait for reimbursement until maturity, on condition, however, that the goods taken out from our pledge be replaced by others subject to our acceptance. If new security is not given we allow partial or total payment immediately by granting discount whose rate depends upon our relation with the client and also upon the general money market.—(Belgian bank.)

In short, continental banks do not compel their customers to make prepayment in anticipation of acceptances. In the period between the arrival of the goods and the payment of the acceptances, the goods are in the possession of the importer, but legal title remains with the bank. In the United States, it is customary for this institution to protect its interest by having the importer sign a trust receipt, but this instrument is not gen-

erally recognized by the laws of most continental countries. Italian law does not permit a lien on goods while they are in the hands of debtors. Banks in Belgium cannot well employ trust receipts, for the law considers that possession of movable goods implies title to the same. Therefore, if merchandise is placed in the hands of a debtor, the creditor loses all his security and, in case of the bankruptcy of the former, the holder of a trust receipt would be regarded merely as a general creditor. However, the trust receipt is employed to some extent by banks in Holland, where the practice is about the same as that followed in the United States.

**VI. Authority to Purchase.**—Quite similar to the letter of credit is the authority to purchase. Its general features have been described in Chap. VIII, and so little consideration need here be given to the operation of this instrument, since it is handled in about the same manner as in American practice. In Belgium it is known as “*l’autorisation de négociation*,” and can be issued in both revocable and irrevocable forms, and with or without recourse to the drawer who draws his bills on the importer. The comparison between the letter of credit and the authority to purchase from the European viewpoint is well summarized in the following statement of an Italian bank:

The letter of credit gives power to the seller to draw upon the issuing bank, whilst the authority to purchase—which we get through and with the guaranteed signature of a bank—gives power to the seller to draw upon the buyer. Nevertheless in both cases we are authorized by a bank to discount the drafts with its guaranty. We consider ourselves as identically guarantors in both the cases. In discounting we take into consideration the difference of the two types of paper.

**VII. Conclusion.**—From the above survey it is clear that in the countries under consideration commercial credits are governed by almost the same principles which apply in the United States. There are, however, differences in the technique as practiced by institutions of the United States and of these countries. Practice within each country is quite standardized, because the financing of foreign trade is concentrated in the hands of a few institutions, and these follow specific regulations as established by banking associations.



## APPENDICES

### I. Commercial Credit Instruments

FORM 1.—CLEAN COMMERCIAL LETTER OF CREDIT.

THE X BANK OF NEW YORK

Commercial Letter of Credit No. ....

\$.....

New York,

Gentlemen:

We hereby authorize you to value on

for account of .....  
up to an aggregate amount of ..... dollars  
available by your drafts at .....

Any draft drawn under this credit must state that it is "Drawn under  
letter of credit No. ...., dated New York, ....., "  
and must be advised to .....

We hereby agree with bona-fide holders that all drafts issued by virtue  
of this credit and in accordance with the above stipulated terms, shall  
meet with due honor upon presentation at the office of .....  
if drawn and negotiated.

## FORM 2.—IRREVOCABLE CREDIT.

(Form Proposed by Commercial Credit Conference.)

Credit No. B.....

....., 19...  
(city) .

Dear Sirs:

We hereby open our irrevocable credit in your favor for account of  
 .....  
 for a sum or sums not exceeding a total of .....  
 .....  
 available by your draft on .....  
 at .....  
 to be accompanied by .....  
 .....  
 evidencing shipment of:  
 .....  
 .....

..... insurance to be effected by .....

All drafts so drawn must be marked:

"Drawn under ..... Bank  
 (issuing bank)

Credit No. B....., 19..  
 (date)

(To be used when not all the documents are to accompany draft.)

There must be forwarded by early mail to ..... Bank,  
 at ....., the following documents: .....  
 ..... All remaining documents must accompany  
 the draft.

The amount of any draft drawn under this credit must, concurrently  
 with negotiation, be endorsed on the reverse hereof; and the presentment  
 of any such draft shall be a warranty by the negotiating bank that such  
 endorsement has been made and that documents have been forwarded as  
 herein required.

This credit must accompany any draft which exhausts the credit and  
 must be surrendered concurrently with the payment of such draft.

Each of the provisions on the back hereof except so far as otherwise  
 expressly stated is incorporated as a part of this credit.

We hereby agree with the drawers, endorsers and bona-fide holders of  
 drafts drawn under and in compliance with the terms of this credit that  
 the same shall be duly honored on due presentation, and delivery of docu-  
 ments as specified at ..... if negotiated  
 on or before ....., 19...

Very truly yours,

## FORM 3.—DOCUMENTARY STERLING COMMERCIAL LETTER OF CREDIT.

## THE X BANK

New York, .....

Commercial Letter of Credit No. ....

£.....

.....

Gentlemen:

We hereby authorize you to value on the Y Bank of London for account of ..... up to an aggregate amount of ..... sterling available by your drafts at ..... against shipment of ..... to ..... Insurance .....

Drafts under this Commercial Letter of Credit must be accompanied by Invoice and by full set of Bills of Lading filled up to the X Bank, New York.

One Bill of Lading and Consular Invoice must be sent direct to us by the Bank or Banker negotiating a draft under this Commercial Letter of Credit, and a Certificate to that effect by such Bank or Banker must be attached to the remaining documents.

Drafts under this Commercial Letter of Credit must be drawn prior to ..... and must state "Drawn against X Bank, New York, Commercial L/C No. ...."

The amount of each draft drawn under this Commercial Letter of Credit, together with the date of negotiation must be endorsed hereon and the Letter of Credit must accompany the final draft.

And we hereby agree with the drawers, endorsers and bona-fide holders of drafts drawn under and in compliance with the terms of this Commercial Letter of Credit that the same shall be duly honored upon presentation in London.

Faithfully yours,

The X Bank,

FORM 4.—APPLICATION FOR COMMERCIAL LETTER OF CREDIT.

(Form Proposed by Commercial Credit Conference.)

Date .....

.....  
(opening bank)  
.....  
(address)

Dear Sirs:

I  
We hereby request you to open and transmit by  $\frac{\text{cable}}{\text{mail}}$  an  $\frac{\text{irrevocable let-}}{\text{authority}}$   
ter of credit  
to pay .....  
in favor of .....  
(beneficiary)

for a sum or sums not exceeding a total of .....  
(amount in words)  
available by drafts on ..... (if on applicant, without recourse)  
at .....  
(tenor of drafts)

if accompanied by the following documents:  
Full set of negotiable ocean bills of lading made out to the  
order of ..... Bank.  
(opening bank)

Cross out Commercial invoice  
documents Consular invoice  
not Marine insurance policy or certificate  
required. War risk insurance policy or certificate  
Certificate of .....  
Certificate of .....  
.....

evidencing shipment from .....  
to ..... of  $\frac{\%}{\text{full}}$  invoice cost of .....  
C.I.F. (name of vessel)  
..... F.A.S. ....  
(property) (place)

F.O.B. (vessel)  
War risk  
Marine insurance to be effect by  $\frac{\text{me}}{\text{us}}$  under blanket policy No. ....  
issued by .....  
(name of insurance company)

This credit is (not) to be confirmed by a correspondent bank.

Drafts must be drawn and presented, or negotiated, not later than  
.....  
(expiration date)

I  
We hereby agree to sign, and deliver to you, an agreement for such  
credit, in the form now used by you, the provisions of which are agreed  
to as defining your rights and  $\frac{\text{my}}{\text{our}}$  obligations. Each of the provisions on  
the back hereof, except so far as otherwise expressly stated, is to be incor-  
porated as part of the credit.

Yours very truly

.....  
.....

## FORM 5.—COMMERCIAL LETTER OF CREDIT AGREEMENT.

(Form Proposed by Commercial Credit Conference.)

Dear Sirs:

In consideration of your opening, at our request, your Commercial Letter of Credit No. . . . ., (herein called "the Credit") the terms of which appear on the reverse side hereof, and are hereby approved by us, we hereby agree as follows:

1. As to drafts or acceptances under or purporting to be under the Credit, which are payable in United States currency, we agree: (a) in the case of each sight draft, to reimburse you at your (New York) office, on demand, in United States gold coin, the amount paid on such draft; or if so demanded by you to pay you at your office in advance in such coin the amount required to pay such draft; and (b) in the case of each acceptance, to pay to you, at your (New York) office, in United States gold coin, the amount thereof, on demand but not later than one day prior to maturity, or, in case the acceptance is not payable at your (New York) office, then on demand, but in any event in time to reach the place of payment in the course of the mails not later than one business day prior to maturity.

2. As to drafts or acceptances under or purporting to be under the Credit, which are payable in currency other than United States currency, we agree: (a) in the case of each sight draft, to reimburse you, at your (New York) office, on demand, the equivalent of the amount paid, in United States gold coin at the rate of exchange then current in (New York) for cable transfers to the place of payment in the currency in which such draft is drawn; and (b) in the case of each acceptance, to furnish you, at your (New York) office, on demand, but in any event in time to reach the place of payment in the course of the mails not later than one business day prior to maturity, with first class bankers' demand bills of exchange to be approved by you for the amount of acceptance, payable in the currency of the acceptance and bearing our endorsement, or, if you so request, to pay to you, at your (New York) office, on demand, the equivalent of the acceptance in United States gold coin at the rate of exchange then current in (New York) for cable transfers to the place of payment in the currency in which the acceptance is payable.

3. We also agree to pay to you, on demand, a commission at the rate of . . . . . per cent, (     %) on such part of the Credit as may be used, and, in any event, a minimum commission of . . . . . per cent, of the amount of the Credit, and all charges and expenses paid or incurred by you in connection therewith, and interest where chargeable.

4. We hereby recognize and admit your ownership in and unqualified right to the possession and disposal of all property shipped under or pursuant to or in connection with the Credit or in any way relative thereto or to the drafts drawn thereunder, whether or not released to us on trust or bailee receipt, and also in and to all shipping documents, warehouse

receipts, policies or certificates of insurance and other documents accompanying or relative to drafts drawn under the Credit, and in and to the proceeds of each and all of the foregoing, until such time as all the obligations and liabilities of us or any of us to you at any time existing under or with reference to the Credit or this agreement or any other credit or any other obligation or liability to you have been fully paid and discharged, all as security for such obligations and liabilities; and that all or any of such property and documents, and the proceeds of any thereof, coming into the possession of you or any of your correspondents, may be held and disposed of by you as hereinafter provided; and the receipt by you, or any of your correspondents, at any time of other security, of whatsoever nature, including cash, shall not be deemed a waiver of any of your rights or powers herein recognized.

5. Except in so far as instructions have been heretofore given by us in writing expressly to the contrary, we agree that you and any of your correspondents may receive and accept as "bills of lading" under the Credit, any documents issued or purporting to be issued by or on behalf of any carrier which acknowledge receipt of property for transportation, whatever the specific provisions of such documents, and that the date of each such document shall be deemed the date of shipment of the property mentioned therein; and that you may receive and accept as documents of insurance either insurance policies or insurance certificates.

6. Except in so far as instructions have been heretofore given by us in writing expressly to the contrary, we agree that part shipments may be made under the Credit and you may honor the relative drafts; and that if the Credit specifies shipments in instalments within stated periods, and the shipper fails to ship in any designated period, shipments of subsequent instalments may nevertheless be made in their respective designated periods and you may honor the relative drafts.

7. We agree that in the event of any extension of the maturity or time for presentation of drafts, acceptances or documents, or any other modification of the terms of the Credit, at the request of any of us, with or without notification to the others, or in the event of any increase in the amount of the Credit at our request, this agreement shall be binding upon us with regard to the Credit so increased or otherwise modified, to drafts, documents and property covered thereby, and to any action taken by you or any of your correspondents in accordance with such extension, increase, or other modification.

8. The users of the Credit shall be deemed our agents and we assume all risks of their acts or omissions. Neither you nor your correspondents shall be responsible: for the existence, character, quality, quantity, condition, packing, value, or delivery of the property purporting to be represented by documents; for any difference in character, quality, quantity, condition, or value of the property from that expressed in documents; for the validity, sufficiency, or genuineness of documents, even if such documents should in fact prove to be in any or all respects invalid, insufficient, fraudulent or forged; for the time, place, manner, or order in which ship-

ment is made; for partial or incomplete shipment, or failure or omission to ship any or all of the property referred to in the Credit; for the character, adequacy, validity, or genuineness of any insurance; for the solvency or responsibility of any insurer, or for any other risk connected with insurance; for any deviation from instructions, delay, default or fraud by the shipper or anyone else in connection with the property or the shipping thereof; for the solvency, responsibility or relationship to the property of any party issuing any documents in connection with the property; for delay in arrival or failure to arrive of either the property or any of the documents relating thereto; for delay in giving or failure to give notice of arrival or any other notice; for any breach of contract between the shippers or venders and ourselves or any of us; for failure of any draft to bear any reference or adequate reference to the Credit, or failure of documents to accompany any draft at negotiation, or failure of any person to note the amount of any draft on the reverse of the Credit or to surrender or take up the Credit or to send forward documents apart from drafts as required by the terms of the Credit; each of which provisions if contained in the Credit itself it is agreed may be waived by you or for errors, omissions, interruptions or delays in transmission or delivery of any messages, by mail, cable, telegraph, wireless or otherwise, whether or not they be in cipher; nor shall you be responsible for any error, neglect, or default of any of your correspondents; and none of the above shall affect, impair, or prevent the vesting of any of your rights or powers hereunder. In furtherance and extension and not in limitation of the specific provisions hereinbefore set forth, we agree that any action taken by you or by any correspondent of yours under or in connection with the Credit or the relative drafts, documents or property, if taken in good faith, shall be binding on us and shall not put you or your correspondent under any resulting liability to us; and we make like agreement as to any inaction or omission, unless in breach of good faith.

9. We agree to procure promptly any necessary import and export or other licenses for the import or export or shipping of the property and to comply with all foreign and domestic governmental regulations in regard to the shipment of the property or the financing thereof, and to furnish such certificates in that respect as you may at any time require, and to keep the property adequately covered by insurance satisfactory to you, in companies satisfactory to you, and to assign the policies or certificates of insurance to you, or to make the loss or adjustment, if any, payable to you, at your option; and to furnish you if demanded with evidence of acceptance by the insurers of such assignment.

10. Each of us agrees at any time and from time to time, on demand, to deliver, convey, transfer, or assign to you, as security for any and all of his and/or our obligations and liabilities hereunder, and also for any and all other obligations and liabilities, absolute or contingent, due or to become due, which are now or may at any time hereafter be owing by him or us to you, additional security of a value and character satisfactory to you, or to make such cash payment ■ you may require. Each of us agrees

that all property belonging to him, or us, or in which he or we may have an interest, of every name and nature whatsoever, now or at any time hereafter delivered, conveyed, transferred, assigned, or paid to you, or coming into your possession or into the possession of anyone for you in any manner whatsoever, whether expressly as security for any of the obligations or liabilities by him or us to you, or for safekeeping or otherwise, including any items received for collection or transmission and the proceeds thereof, whether or not such property is in whole or in part released to us on trust or bailee receipt, are hereby made security for each and all such obligations and liabilities. Each of us agrees that upon his or our failure at all times to keep a margin of security with you satisfactory to you, or upon the making by him or us of any assignment for the benefit of creditors, or upon the filing of any voluntary or involuntary petition in bankruptcy by or against him or us, or upon any application for the appointment of a receiver of any of his or our property, or upon any act of bankruptcy or state of insolvency of him or us, all of such obligations and liabilities shall become and be immediately due and payable without demand or notice, notwithstanding any credit or time allowed to him or us, or any instrument evidencing any such obligations or liabilities or otherwise; and each of us, as to property in which he may have any interest, and all of us, as to property in which we may have any interest, expressly authorize you in any such event, or upon his or our failure to pay any of such obligations or liabilities when it or they shall become or be made due, to sell immediately, without demand for payment, without advertisement and without notice to us, or any of us, all of which are hereby expressly waived, any and all such property, arrived or to arrive, at private sale or at public auction or at brokers' board or otherwise, at your option, in such parcel or parcels and at such time or times and at such place or places and for such price or prices and upon such terms and conditions as you may deem proper, and to apply the net proceeds of such sale or sales, together with any balance of deposits and any sums credit by or due from you to him or us in general account or otherwise, to the payment of any and all of his and/or our obligations or liabilities to you however arising. If any such sale be at brokers' board or at public auction you may yourself be a purchaser at such sale, free from any right of redemption, which we and each of us hereby expressly waive and release.

11. You shall not be deemed to have waived any of your rights hereunder, unless you or your authorized agent shall have signed such waiver in writing. No such waiver, unless expressly as stated therein, shall be effective as to any transaction which occurs subsequent to the date of such waiver, nor as to any continuance of a breach after such waiver.

12. The word "property" as used in this agreement includes goods, merchandise, securities, funds, choses in action, and any and all other forms of property, whether real, personal or mixed and any right or interest therein.

13. If this agreement is signed by one individual, the terms "we,"

"our," "us," shall be read throughout as "I," "my," "me," as the case may be. If this agreement is signed by two or more parties, it shall be the joint and several agreement of such parties.

Yours very truly,

FORM 6.—RESOLUTION AUTHORIZING APPOINTMENT OF AGENT.

RESOLUTION AUTHORIZING APPOINTMENT OF X BANK, NEW YORK, AGENT TO ESTABLISH COMMERCIAL CREDIT

WHEREAS, it is desirable to make satisfactory arrangements for the establishment of commercial credits applied for by our customers, now therefore,

RESOLVED:

That the following officers, namely: .....

(specify, president, vice-president, etc.)

..... are, and each of them is, hereby authorized to execute in behalf of this corporation instruments appointing the X Bank, New York, agent of this corporation to establish the particular credits specified in said instruments, empowering said agent to accept and pay, either directly or through its correspondents, drafts drawn against said credits and to surrender, on trust receipts or otherwise, any goods shipped thereunder or the documents representing said goods, and incorporating such provisions for the securing, indemnifying and reimbursing of said agent as may be deemed appropriate in the discretion of the officer or officers executing said instruments.

That the foregoing shall continue in force until express notice of revocation shall have been duly given in writing to the X Bank, New York.

The undersigned ....., does hereby certify that the foregoing is a true extract from the minutes of a meeting of the Board of Directors of ..... duly called and held at ..... the ..... day of ....., 192., a quorum being present.

IN WITNESS WHEREOF, I have hereunto set my hand and affixed the official seal of said corporation this ..... day of ....., 192...

As

(SEAL)

FORM 7.—APPOINTMENT OF BANK AGENT.

APPOINTMENT OF X BANK, NEW YORK, AGENT TO ESTABLISH  
COMMERCIAL CREDIT

TO X BANK, NEW YORK:

The undersigned .....  
(name of bank or trust company)  
hereby appoints you its agent to establish in your own name the credit  
applied for by ..... in the attached form,  
dated ....., 192., and authorizes you and your correspond-  
ents to accept and pay drafts drawn against said credit if accompanied  
by the documents specified in said application to an amount not exceeding  
.....

(specify amount in words and figures)  
and the undersigned agrees to reimburse you on demand at New York  
City, (and, if foreign currency is specified above, in equivalent United  
States money, at the rate of exchange current when reimbursement is  
made) any amounts paid under said credit, and any and all expenses of  
every kind incurred by you in connection with the transaction; and also to  
pay you your usual charges and commissions and, if requested, interest  
on all sums due.

In consideration of your establishing the aforesaid credit, the under-  
signed hereby assigns to you as security all its rights under said attached  
application and agrees to deliver to you upon demand such additional  
security as you may request, and also hereby gives you a lien on all its  
property, including deposit balances, now or hereafter in your possession  
for the amount of any liability of the undersigned to you hereunder or  
otherwise; and agrees that, should it suspend payment for any reason, all  
its obligations and liabilities to you shall immediately, without notice,  
become due and payable at your option, then or thereafter exercised.

You are authorized to surrender on trust receipt to  
.....  
or on their order from time to time any goods shipped under this credit,  
or the documents representing the same.

All rights hereunder shall be determined in accordance with the laws of  
the State of New York.

.....  
.....  
.....  
Dated at ....., 192...

APPROVED	

.....  
(name of bank or trust company)

By.....

As.....  
(official title)

## FORM 8.—IRREVOCABLE STRAIGHT CREDIT.

(Form Proposed by Commercial Credit Conference—Interbank Form C.)

Credit No. C.....

....., 19...

(correspondent bank)

(city)

Dear Sirs:

We request you to advise .....

(name)

(address)

(city)

(state)

that we have opened our irrevocable credit in their favor for account  
of .....

for a sum or sums not exceeding a total of .....

(figures)

(words)

available by their drafts on you .....

at .....

to be accompanied by .....

evidencing shipment of:

..... insurance to be effected by .....

We engage with the beneficiary that all drafts drawn under and in compliance with the terms of this advice will be duly honored on delivery of documents as specified at ..... if presented at your office on or before ....., 19...

For your reimbursement you may:

(Put cross in  
square opposite  
method desired.)

Debit our account with you

Draw on us at .....

This credit is to be advised to the beneficiary by you on Commercial Credit Conference Form C.

Yours very truly,

FORM 9.—CONFIRMED IRREVOCABLE NEGOTIATION CREDIT.

(Form Proposed by Commercial Credit Conference—Interbank Form D.)

Credit No. D-b.....  
.....19...  
(city)  
.....  
(correspondent bank)  
.....

Dear Sirs:

We request you to advise.....  
.....  
(address) (city) (state)  
that we have opened our irrevocable credit in their favor for account of:  
.....  
for a sum or sums not exceeding a total of..... (figures)  
..... (words)  
available by their drafts on.....  
(if on accredited buyer, without recourse)  
at.....to be accompanied by.....  
evidencing shipment of: .....  
.....insurance to be effected by.....  
(To be used when not all the documents are to accompany draft.)

There must be forwarded by early mail by the negotiating bank to  
.....at.....the following docu-  
ments,..... All remaining documents must accom-  
pany the draft.

We engage with the drawers, endorsers and bona fide holders of drafts drawn under and in compliance with the terms of the credit that the same shall be duly honored on due presentation and delivery of documents as specified, if negotiated or presented at.....on or before  
.....19...; we authorize you to confirm the credit and thereby to undertake that drafts drawn and presented as above speci-  
fied shall be duly honored.

If the terms of the credit authorize the beneficiary to draw on you, for your reimbursement you may

(Put cross in square      Debit our account with you.  
opposite method desired)      Draw on us at.....

This credit is to be advised to the beneficiary by you on Commercial Credit Conference Form D-b.

Yours very truly,

FORM 10.—AUTHORITY TO PAY.

(Form Proposed by Commercial Credit Conference—Interbank Form A.)

Authority No. A.....

....., 19...

(correspondent bank)

(city)

Dear Sirs:

We request you to advise .....  
(name)

(address)

(city)

(state)

that we have authorized you to honor their draft for account of.....

for a sum or sums not exceeding a total of.....

(figures)

(words)

on .....

at .....

to be accompanied by .....

evidencing shipment of:

.....insurance to be effected by.....

This authority is valid for drafts so drawn, with documents as specified,  
presented at your office ....., not later than .....,  
19..., unless it is previously revoked or modified by receipt by you of  
notice from us to that effect.

For your reimbursement you may:

(Put cross in  
square opposite  
method desired.)

Debit our account with you.

Draw on us at .....

This authority is to be advised to the beneficiary by you on Commercial  
Credit Conference Form A.

Yours very truly,

## FORM 11.—CORRESPONDENT'S IRREVOCABLE STRAIGHT CREDIT.

(Form Proposed by Commercial Credit Conference—Form C.)

Advice No. C.....

....., 19...  
(city)

Dear Sirs:

We are instructed by ..... Bank  
 (corresponding bank)  
 to advise you that they have opened their irrevocable credit in your favor  
 for account of .....  
 for a sum or sums not exceeding a total of .....  
 (figures)

.....  
 (words)

available by your drafts on .....

at .....

to be accompanied by .....

.....

evidencing shipment of:

.....

.....

..... insurance to be effected by .....  
 All drafts so drawn must be marked:

"Drawn as per ..... Bank's  
 (advising bank)

Advice No. C..... Dated ..... 19..."

Each of the provisions on the back hereof, except so far as otherwise  
 expressly stated, are incorporated as a part of this advice.

..... Bank engages with you that all drafts drawn  
 (correspondent bank)

under and in compliance with the terms of this advice will be duly honored  
 on delivery of documents as specified if presented at this office on or before  
 ....., 19....

This letter is solely an advice of credit opened by .....  
 (correspondent bank)

Bank and conveys no engagement by us.

Very truly yours,

## FORM 12.—CONFIRMED IRREVOCABLE NEGOTIATION CREDIT.

(Form Proposed by Commercial Credit Conference—Form D.)

Credit No. D-b.....

....., 19....  
(city)

Dear Sirs:

We are instructed by.....Bank  
(correspondent bank)to advise you that they have opened their irrevocable credit in your favor  
for account of.....

for a sum or sums not exceeding a total of.....(figures)

.....(words)

available by your drafts on.....

at.....to be accompanied by.....

evidencing shipment of:

.....insurance to be effected by.....

All drafts drawn under the credit must be marked:

“Drawn under.....Bank’s

(advising bank)

Credit No. D-b....., dated.....19....”

(To be used when not all the documents are to accompany draft.)

There must be forwarded by early mail by the negotiating bank to  
.....Bank, at....., the following  
(address)documents: ..... All remaining docu-  
ments must accompany the draft.The presentment of each draft, if negotiated, shall be a warranty by the  
negotiating bank that documents have been forwarded as herein required,  
and that the amount of each draft has been endorsed on the reverse hereof;  
otherwise, this credit and all relative documents must accompany the draft.The credit must accompany any draft which exhausts the credit and  
must be surrendered concurrently with the payment of such draft.Each of the provisions on the back hereof, except so far as otherwise  
expressly stated, is incorporated as part of this credit......Bank engages with the drawers, endorsers and bona  
(correspondent bank)fide holders of drafts drawn under and in compliance with the terms of  
this advice that the same shall be duly honored on due presentation and  
delivery of documents as specified, if negotiated, or presented at.....  
.....on or before....., 19....;  
we confirm the credit and thereby undertake that drafts drawn and pre-  
sented as above specified shall be duly honored.

Yours very truly,

## FORM 13.—ADVICE OF AUTHORITY TO PAY.

(Form Proposed by Commercial Credit Conference—Form A.)

Advice No. A.....

....., 19...  
(city)

Dear Sirs:

We advise you that .....  
(correspondent bank)

have authorized us to honor your drafts for account of.....

(opening firm)

for a sum or sums not exceeding a total of.....

(figures)

(words)

on us at.....

to be accompanied by .....

evidencing shipment of:

..... insurance to be effected by .....  
All drafts so drawn must be marked:"Drawn as per ..... Bank's  
(advising bank)

Advice No. A..... Dated ....., 19..."

Drafts so drawn, with documents as specified, must be presented at our  
office..... not later than....., 19....The authority given to us is subject to revocation or modification at  
any time without notice to you.Each of the provisions on the back hereof, except so far as otherwise  
expressly stated, are incorporated as a part of this advice.This advice conveys no engagement on our part or on the part of  
..... Bank and is simply for your guidance in pre-  
(correspondent bank)

paring and presenting drafts and documents.

Yours very truly,

## FORM 14.—TRUST RECEIPT.

New York City, ....., 19...

Received from the X Bank of New York, for one of the following purposes, as indicated by (x).

- ☐ 1. For Export Shipment.  
☐ 2. For Warehousing.  
☐ 3. To Exchange for Domestic Order Bills of Lading (Railroad or Steamship).  
☐ 4. For immediate delivery to ..... who have/has purchased the same for \$..... payable ..... and to obtain from the purchaser the proceeds of the sale.  
☐ 5. For

the goods and merchandise specified in the documents described below, both such documents and said goods and merchandise belonging to and being the property of the said Bank, and in consideration thereof I/we hereby agree to hold said goods and merchandise in trust for it and as its property and to deliver over to the said Bank or its assigns, immediately upon the receipt thereof by me/us, and in any event not later than (Date)..... any one of the following representing the goods and merchandise described below according to the purpose for which the original documents are withdrawn:

1. Complete Set of Order Ocean Bills of Lading.
2. Negotiable Warehouse Receipts of the XYZ Warehouse Company or other warehouses satisfactory to said Trust Company.
3. Domestic Order Bills of Lading. (Railroad or Steamship.)
4. Proceeds of the sale of such goods or merchandise, it being understood that immediately upon receipt by me/us of such proceeds the same shall be delivered to the said Bank in whatever form collected and whether or not my/our obligation to it shall have matured. It is understood that such proceeds are to be applied by said Bank against my/our indebtedness to said Bank, whether due or to become due. However, if such proceeds be in notes, bills receivable or acceptances, they shall not be so applied until paid, but held until maturity by said Bank, with liberty meanwhile to sell or discount and so apply the net proceeds.
- 5.

The delivery herein is temporarily made to me/us for convenience only, without novation, or without giving me/us any title to the documents or the goods and merchandise they represent, except as trustee and agent for the said Bank for the purposes herein indicated.

Said Bank may at any time cancel this trust and take possession of said goods and merchandise or any of said documents or of the proceeds of the same wherever said goods and merchandise and documents or the proceeds thereof may then be found or located, and in the event of suspension, proceedings in bankruptcy or assignment for the benefit of creditors on my/our part or of the non-fulfillment of any obligation or of the non-payment at maturity of any indebtedness on my/our part to said Bank, then in any such case, all obligations, acceptances, indebtedness and liabilities whatsoever shall forthwith mature and become due and payable.

The said goods and merchandise shall at all times at my/our expense, be fully insured against loss by fire and any other risk that said goods and merchandise may be subject to. The insurance policies or certificates of acceptable companies in proper form showing loss, if any, payable to the X Bank of New York, will be deposited with it on demand.

The undersigned in further assurance, agree that insofar as the undersigned may make entries of records of transactions herein set forth or provided for in the books of account of the undersigned, such entries shall definitely indicate that said merchandise and documents and the proceeds thereof are the property of said Bank.

Receipt of a copy of this Trust Receipt is herewith acknowledged.

DESCRIPTION OF DOCUMENT	QUANTITY	GOODS AND MERCHANDISE	VALUE
		(give marks and numbers)	

Signed.....

## II. Uniform Commercial Credit Regulations of the Commercial Credit Conference

A. (1) Railroad export and forwarders' bills of lading will not be accepted.

(2) Ocean bills of lading permitting transshipment will be accepted.

B. (1) Bills of lading shall contain no words qualifying the acceptance of shipments in apparent good order and condition.

(2) "Received-for-shipment" or "alongside" bills of lading will be accepted and the date thereof taken to be the date of shipment; in this case insurance shall cover the shipment from such date of shipment and on whatever vessels carried.

(3) When the "on-board" shipment is required, the date of such endorsement will be taken to be the date upon which shipment has been effected.

(4) Any extension of the date of shipment shall extend for an equal length of time the date for presentation or negotiation, and vice versa.

C. The term "insurance" shall be construed as including underwriters' certificate of insurance.

D. A shipment for any part of the specified property may be drawn against if the pro rata value can be verified.

E. If shipment in installments within stated periods is specified, and there is a failure to ship in any designated period, shipments of subsequent installments, made in their respective designated periods, may be drawn against.

F. When the indicated expiration date for presentation or negotiation falls upon a Sunday or legal holiday, the expiration is extended to the next succeeding business day.

G. Presentation must be made during the usual banking hours.

H. The terms "prompt shipment," "shipment as soon as possible," "immediate shipment" or words of similar import shall be interpreted as requiring shipment to be effected within thirty days, and, if no date for presentation or negotiation is stated, such presentation or negotiation must be made within thirty days from the date of the credit or advice.

I. Documents representing more than the specified quantity of property may be accepted in the discretion of the paying or

negotiating bank without thereby binding the buyer to accept or pay for such excesses but payment shall be limited to the sum named in the credit or advice.

J. The terms "approximately," "about," or words of similar import, shall be construed to permit a variation of not exceeding ten per centum from the named sum or quantity.

K. Drafts drawn without recourse will not be honored.

L. Definitions of Export Quotations will be those adopted by the National Foreign Trade Council, Chamber of Commerce of the U. S. A., National Association of Manufacturers, American Manufacturers' Export Association, Philadelphia Commercial Museum, American Exporters and Importers Association, Chamber of Commerce of the State of New York, New York Produce Exchange and the Merchants' Association of New York at a conference held in India House, New York, on Dec. 16, 1919.

### III. The Hague Rules, 1921

#### Article I.—Definitions.

- a. "Carrier" includes the owner or the charterer who enters into a contract of carriage with a shipper.
- b. "Contract of carriage" means a bill of lading or any similar document of title in so far as such document relates to the carriage of goods by the sea.
- c. "Goods" includes goods, wares, merchandise, and articles of every kind whatsoever except live animals and cargo carried on deck.
- d. "Ship" includes any vessel used for the carriage of goods by sea.
- e. "Carriage of goods" covers the period from the time when the goods are received on the ship's tackle to the time when they are unloaded from the ship's tackle.

#### Article II.—Risks

Subject to the provisions of Article V, under every contract of carriage of goods by sea the carrier, in regard to the handling, loading, stowage, carriage, custody, care, and unloading of such goods, shall be subject to the responsibilities and liabilities and entitled to the rights and immunities hereinafter set forth.

### Article III.—Responsibilities and Liabilities

1. The carrier shall be bound before and at the beginning of the voyage to exercise due diligence to

- a. make the ship seaworthy;
- b. properly man, equip, and supply the ship;
- c. make the holds, refrigerating and cool chambers, and all other parts of the ship in which goods are carried fit and safe for their reception, carriage, and preservation.

2. The carrier shall be bound to provide for the proper and careful handling, loading, stowage, carriage, custody, care, and unloading of the goods carried.

3. After receiving the goods into his charge the carrier, or the master or agent of the carrier, shall, on the demand of the shipper, issue a bill of lading showing, amongst other things,

- a. the leading marks necessary for identification of the goods as the same are furnished in writing by the shipper before the loading starts, provided such marks are stamped or otherwise shown clearly upon the goods if uncovered, or on the cases or coverings in which such goods are contained, in such a manner as will remain legible until the end of the voyage;
- b. the number of packages or pieces, or the quantity or weight, as the case may be, as furnished in writing by the shipper before the loading starts;
- c. the apparent order and condition of the goods.

Provided that no carrier, master or agent of the carrier, shall be bound to issue a bill of lading showing description, marks, number, quantity, or weight which he has reasonable ground for suspecting do not accurately represent the goods actually received.

4. Such a bill of lading issued in respect of goods other than goods carried in bulk and whole cargoes of timber shall be prima facie evidence of the receipt by the carrier of the goods as therein described in accordance with section 3 (a), (b), and (c). Upon any claim against the carrier in the case of goods carried in bulk or whole cargoes of timber, the claimant shall be bound, notwithstanding the bill of lading, to prove the number, quantity, or weight actually delivered to the carrier.

5. The shipper shall be deemed to have guaranteed to the car-

rier the accuracy of the description, marks, number, quantity, and weight as furnished by him, and the shipper shall indemnify the carrier against all loss, damages, and expenses arising or resulting from inaccuracies in such particulars.

6. Unless written notice of a claim for loss or damage and the general nature of such claim be given in writing to the carrier or his agent at the port of discharge before the removal of the goods, such removal shall be *prima facie* evidence of the delivery by the carrier of the goods as described in the bill of lading, and in any event the carrier and the ship shall be discharged from all liability in respect of loss or damage unless suit is brought within 12 months after the delivery of the goods.

7. After the goods are loaded, the bill of lading to be issued by the carrier, master or agent of the carrier to the shipper shall, if the shipper so demands, be a "shipped" bill of lading, provided that no "received for shipment" bill of lading or other document of title shall have been previously issued in respect of the goods.

In exchange for, and upon surrender of, a "received for shipment" bill of lading, the shipper shall be entitled, when the goods have been loaded, to receive a "shipped" bill of lading.

A "received for shipment" bill of lading which has subsequently been noted by the carrier, master, or agent with the name or names of the ship or ships upon which the goods have been shipped and the date or dates of shipment, shall, for the purpose of these rules, be deemed to constitute a "shipped" bill of lading.

8. Any clause, covenant, or agreement in a contract of carriage relieving the carrier or the ship from liability for loss or damage to or in connection with goods arising from negligence, fault, or failure in the duties and obligations provided in this article or lessening such liability otherwise than as provided in these rules shall be null and void and of no effect.

#### Article IV.—Rights and Immunities

1. Neither the carrier nor the ship shall be liable for loss or damage arising or resulting from unseaworthiness unless caused by want of due diligence on the part of the carrier to make the

ship seaworthy, and to secure that the ship is properly manned, equipped, and supplied.

2. Neither the carrier nor the ship shall be responsible for loss or damage arising or resulting from

- a. act, neglect, or default of the master, mariner, pilot, or the servants of the carrier in the navigation or in the management of the ship;
- b. fire;
- c. perils, dangers, and accidents of the sea or other navigable waters;
- d. act of God;
- e. act of war;
- f. act of public enemies;
- g. arrest or restraint of princes, rulers, or people, or seizure under legal process;
- h. quarantine restrictions;
- i. act or omission of the shipper or owner of the goods, his agent or representative;
- j. strikes or lockouts or stoppage or restraint of labor from whatever cause, whether partial or general;
- k. riots and civil commotions;
  - l. saving or attempting to save life or property at sea;
- m. inherent defect, quality, or vice of the goods;
- n. insufficiency of packing;
- o. insufficiency or inadequacy of marks;
- p. latent defects not discoverable by due diligence;
- q. any other cause arising without the actual fault or privity of the carrier, or without the fault or neglect of the agents, servants, or employees of the carrier.

3. Any deviation in saving or attempting to save life or property at sea or any deviation authorized by the contract of carriage shall not be deemed to be an infringement or breach of these rules or of the contract of carriage, and the carrier shall not be liable for any loss or damage resulting therefrom.

4. Neither the carrier nor the ship shall be responsible in any event for loss or damage to or in connection with goods in an amount beyond £100 per package or unit, or the equivalent of that sum in other currency, unless the nature and value of such goods have been declared by the shipper before the goods are shipped and have been inserted in the bill of lading.

By agreement between the carrier, master or agent of the carrier, and the shipper another maximum amount than mentioned in this paragraph may be fixed, provided that such maximum shall not be less than the figures above named.

The declaration by the shipper as to the nature and value of any goods declared shall be *prima facie* evidence, but shall not be binding or conclusive on the carrier.

5. Neither the carrier nor the ship shall be responsible in any event for loss or damage to or in connection with goods if the nature or value thereof has been willfully misstated by the shipper.

6. Goods of an inflammable or explosive nature or of a dangerous nature, unless the nature and character thereof have been declared in writing by the shipper to the carrier before shipment and the carrier, master or agent of the carrier has consented to their shipment, may at any time before delivery be destroyed or rendered innocuous by the carrier without compensation to the shipper, and the shipper of such goods shall be liable for all damages and expenses directly or indirectly arising out of or resulting from such shipment. If any such goods shipped with such consent shall become a danger to the ship or cargo they may in like manner be destroyed or rendered innocuous by the shipper.

7. A carrier shall be at liberty to surrender in whole or in part all or any of his rights and immunities under this article, provided such surrender shall be embodied in the bill of lading issued to the shipper.

### Article V.—Special Conditions

Notwithstanding the provisions of the preceding articles a carrier and a shipper shall in regard to any particular goods be at liberty to enter into any agreement in any terms as to the responsibility and liability of the carrier for such goods, and as to the rights and immunities of the carrier in respect of such goods, or his obligation as to seaworthiness, or the care or diligence of his servants or agents in regard to the handling, loading, stowing, custody, care, and unloading of the goods carried by sea, provided that in this case no bill of lading shall be issued and that the terms agreed shall be embodied in a receipt which shall be a non-negotiable document and shall be marked as such.

Any agreement so entered into shall have full legal effect.

## Article VI.—Limitations on the Application of the Rules

Nothing herein contained shall prevent a carrier or a shipper from entering into any agreement, stipulation, condition, reservation, or exemption as to the responsibility and liability of the carrier or the ship for the loss or damage to or in connection with the custody and care and handling of goods prior to the loading on and subsequent to the unloading from the ship on which the goods are carried by sea.

## Article VII.—Limitation of Liability

The provisions of these rules shall not affect the rights and obligations of the carrier under the convention relating to the limitation of the liability of owners of sea-going vessels.

### IV. Points of Variance between the Hague Rules and the Harter Act<sup>1</sup>

*A. As to seaworthiness.*—The rules (1) require the carrier to exercise due diligence to make his ship in every way seaworthy (Art. III, Sec. 1; (2) make null and void any agreement which reassures the carrier from liability if he fails in the performance of this duty (Art. III, Sec. 8) and (3) relieve the carrier from responsibility for loss or damage arising from errors in the navigation or the management of the ship (Art. IV, Sec. 2).

These provisions differ from those of the Harter act only in that the latter provides (Sec. 3) that "if the owner . . . shall exercise due diligence to make the said vessel in all respects seaworthy," he shall not be liable for damage or loss resulting from faults or errors in the navigation or in the management of the vessel. The statement of the carrier's right to exemption in the conditional form of the Harter act, is believed to be less satisfactory than the form adopted in the Rules.

*B. Bulk Cargoes.*—The rules provide that a bill of lading issued for bulk cargoes and whole cargoes of timber shall not be prima facie evidence against the carrier, and that, when a claim is made for shortage in the delivery of such cargoes, the claimant must prove the quantity actually loaded.

<sup>1</sup> Article by Charles S. Haight in *Journal of Commerce*, Feb. 23, 1922.

The Harter act draws no distinction between bulk and other cargoes, and applies to everything except live animals. Here again, it is believed that the rules are an improvement. When coal is loaded under the chutes or grain from an elevator, the master has no means of knowing the precise weight loaded, and proof of that weight should, in fairness, be given, if subsequently required to substantiate a claim for shortage.

*C. Special Cargoes.*—The rules allow the issuance of a non-negotiable document for the carriage of special kinds of cargo which are extra hazardous, or which, for any other reason, cannot appropriately be carried under the restrictions of the Rules (Art. V).

The Harter act makes no provision for the carriage of such cargo, and it is believed that this omission is one which needs to be covered. It serves no good purpose to have our law in such shape that damaged cargo, for instance, resulting from salvage operations and lying on an exposed beach, cannot be accepted by a carrier because it is in such condition that it cannot be handled as ordinary cargo.

*D. The Application of the Rules.*—The rules apply only from the loading of the cargo to its discharge (Art. VI), whereas the Harter act, under normal conditions, applies to cargo before the goods are loaded and may apply after the discharge.

Since The Hague Rules are intended to apply throughout the world, it was considered wise to restrict them to the actual obligations of transportation, leaving undisturbed in each country the law governing carriers' obligations before the goods are loaded and after they are discharged, whatever it may be. The carriers merely insist that while they are acting as warehousemen, either at the loading or at the discharging port, they shall be governed by the same laws that apply to other warehousemen. They ask for no special indulgence.

*E. "Number of Packages."*—The rules require the carrier to issue a bill of lading stating, among other things, "the number of packages or pieces or the quantity or weight as furnished in writing by the shipper before the loading starts" (Art. III, Sec. 3 (b)).

The Harter act provides that the bill of lading must state the "number of packages or quantity, stating whether it be carrier's

or shipper's weight." This does not specifically permit the acceptance of the shipper's count in issuing the bill of lading.

## V. American Foreign Trade Definitions

1. When the price quoted applies only at inland shipping point and the seller merely undertakes to load the goods on or in cars or lighters furnished by the railroad company serving the industry, or most conveniently located to the industry, without other designation as to routing, the proper term is:

"f.o.b. (named point)"

Under this quotation:

### A. Seller must

1. place goods on or in cars or lighters
2. secure railroad bill of lading
3. be responsible for loss and/or damage until goods have been placed in or on cars or lighters at forwarding point, and clean bill of lading has been furnished by the railroad company

### B. Buyer must

1. be responsible for loss and/or damage incurred thereafter
2. pay all transportation charges including taxes, if any
3. handle all subsequent movement of the goods.

2. When the seller quotes a price including transportation charges to the port of exportation without assuming responsibility for the goods after obtaining a clean bill of lading at point of origin, the proper term is:

"f.o.b. (named point) FREIGHT PREPAID TO (named point on the seaboard)"

Under this quotation:

### A. Seller must

1. place goods on or in cars or lighters
2. secure railroad bill of lading
3. pay freight to named port
4. be responsible for loss and/or damage until goods have been placed in or on cars or lighters at forwarding point, and clean bill of lading has been furnished by the railroad company

**B. Buyer must**

1. be responsible for loss and/or damage incurred thereafter
2. handle all subsequent movement of the goods
3. unload goods from cars
4. transport goods to vessels
5. pay all demurrage and/or storage charges
6. arrange for storage in warehouse or on wharf where necessary

3. Where the seller wishes to quote a price, from which the buyer may deduct the cost of transportation to a given point on the seaboard, without the seller assuming responsibility for the goods after obtaining a clean bill of lading at point of origin, the proper term is:

“f.o.b. (named point) FREIGHT ALLOWED TO (named point on the seaboard)”

Under this quotation:

**A. Seller must**

1. place goods on or in cars or lighters
2. secure railroad bill of lading
3. be responsible for loss and/or damage until goods have been placed in or on cars or lighters at forwarding point, and clean bill of lading has been furnished by the railroad company

**B. Buyer must**

1. be responsible for loss and/or damage incurred thereafter
2. pay all transportation charges (buyer is then entitled to deduct from the amount of the invoice the freight paid from primary point to named port)
3. handle all subsequent movement of the goods
4. unload goods from cars
5. transport goods to vessel
6. pay all demurrage and/or storage charges
7. arrange for storage in warehouse or on wharf where necessary

4. The seller may desire to quote a price covering the transportation of the goods to seaboard, assuming responsibility for loss and/or damage up to that point. In this case, the proper term is:

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“f.o.b Cars (named point on seaboard)”

Under this quotation:

A. Seller must

1. place goods on or in cars
2. secure railroad bill of lading
3. pay all freight charges from forwarding point to port on seaboard
4. be responsible for loss and/or damage until goods have arrived in or on cars at the named port

B. Buyer must

1. be responsible for loss and/or damage incurred thereafter
2. unload goods from cars
3. handle all subsequent movement of the goods
4. transport goods to vessel
5. pay all demurrage and/or storage charges
6. arrange for storage in warehouse or on wharf where necessary

5. It may be that the goods, on which a price is quoted covering the transportation of the goods to the seaboard, constitute less than a carload lot. In this case, the proper term is:

“f.o.b. Cars (named port) L. C. L.”

Under this quotation:

A. Seller must

1. deliver goods to the initial carrier
2. secure railroad bill of lading
3. pay all freight charges from forwarding point to port on seaboard
4. be responsible for loss and/or damage until goods have arrived on cars at the named port

B. Buyer must

1. be responsible for loss and/or damage incurred thereafter
2. handle all subsequent movement of the goods
3. accept goods from the carrier
4. transport goods to vessel
5. pay all storage charges
6. arrange for storage in warehouse or on wharf where necessary

6. Seller may quote a price which will include the expense

of transportation of the goods by rail to the seaboard, including lighterage. In this case, the proper term is:

“f.o.b. Cars (named port) LIGHTERAGE FREE”

Under this quotation:

A. Seller must

1. place goods on or in cars
2. secure railroad bill of lading
3. pay all transportation charges to, including lighterage at, the port named
4. be responsible for loss and/or damage until goods have arrived on cars at the named port

B. Buyer must

1. be responsible for loss and/or damage incurred thereafter
2. handle all subsequent movement of the goods
3. take out the insurance necessary to the safety of the goods after arrival on the cars
4. pay the cost of hoisting goods into vessel where weight of goods is too great for ship's tackle
5. pay all demurrage and other charges, except lighterage charges

7. The seller may desire to quote a price covering delivery of the goods alongside overseas vessel and within reach of its loading tackle. In this case, the proper term is:

“f.a.s. vessel (named port)”

Under this quotation:

A. Seller must

1. transport goods to seaboard
2. store goods in warehouse or on wharf if necessary, unless buyer's obligation includes provision of shipping facilities
3. place goods alongside vessel either in a lighter or on the wharf
4. provide the usual dock or ship's receipt
5. be responsible for loss and/or damage until goods have been delivered alongside the ship or on wharf

B. Buyer must

1. be responsible for loss and/or damage thereafter, and for insurance
2. handle all subsequent movement of the goods

3. pay cost of hoisting goods into vessel where weight of goods is too great for ship's tackle
8. The seller may desire to quote a price covering all expenses up to and including delivery of the goods upon the overseas vessel at a named port. In this case, the proper term is:  
"f.o.b. vessel (named port)"

Under this quotation:

A. Seller must

1. meet all charges incurred in placing goods actually on board the vessel
2. provide the usual dock or ship's receipt
3. be responsible for all loss and/or damage until goods have been placed on board the vessel

B. Buyer must

1. be responsible for loss and/or damage thereafter
2. handle all subsequent movement of the goods

9. The seller may be ready to go farther than the delivery of his goods upon the overseas vessel and be willing to pay transportation to a foreign point of delivery. In this case, the proper term is:

"c.&f. (named foreign port)"

Under this quotation:

A. Seller must

1. make freight contract and pay transportation charges sufficient to carry goods to agreed destination
2. deliver to buyer or his agent clean bills of lading to the agreed destination
3. be responsible for loss and/or damage until goods have been delivered alongside the ship and clean ocean bill of lading obtained (seller is not responsible for delivery of goods at destination)

B. Buyer must

1. be responsible for loss and/or damage thereafter and must take out all necessary insurance
2. handle all subsequent movement of the goods
3. take delivery and pay costs of discharge, lighterage and landing at foreign port of destination in accordance with bill of lading clauses
4. pay foreign customs duties and wharfage charges, if any

10. The seller may desire to quote a price covering the cost of the goods, the marine insurance on the goods, and all transportation charges to the foreign point of delivery. In this case, the proper term is:

“c.i.f. (named foreign port)”

Under this quotation:

A. Seller must

1. make freight contract and pay freight charges sufficient to carry goods to agreed destination
2. take out and pay for necessary marine insurance
3. deliver to buyer or his agent clean bills of lading to the agreed destination, and insurance policy and/or negotiable insurance certificate
4. be responsible for loss and/or damage until goods have been delivered alongside the ship, and clean ocean bill of lading and insurance policy and/or negotiable insurance certificate have been delivered to the buyer, or his agent. (Seller is not responsible for the delivery of goods at destination, nor for payment by the underwriters of insurance claims)
5. provide war risk insurance, where necessary, for buyer's account

B. Buyer must

1. be responsible for loss and/or damage thereafter, and must make all claims to which he may be entitled under the insurance directly on the underwriters
2. take delivery and pay costs of discharge, lighterage and landing at foreign ports of destination in accordance with bill of lading clauses
3. pay foreign customs duties and wharfage charges, if any

EXPLANATIONS OF ABBREVIATIONS

f.o.b. ....	Free on board
f.a.s. ....	Free along side
c.&f. ....	Cost and freight
c.i.f. ....	Cost, insurance and freight
l.c.l. ....	Less than carload lot

## VI. Diamond Alkali Export Corp. vs Bourgeois

Law Reports, Kings Bench Division, July 1, 1921, Vol. III, p. 443.

Mr. Justice McCARDIE: By a written contract of August 7, 1920, the Diamond Alkali Export Corp. of New York sold to F. Bourgeois of London 50 tons of soda ash. Shipment was to be September-October from American seaboard. Terms of payment were cash against documents under confirmed bankers' credit at London. Price was c.i.f. Gottenburg. The contract contained (inter alia) this condition: "Seller not liable for failures or delays in delivery due to strikes, lockouts, fire, accident, embargoes, stoppage of navigation, lack of transportation, war restrictions or seizures by any governmental agency or any contingencies whatever beyond seller's control. In case any deliveries are delayed owing to any such contingency, the delayed shipments shall be made as soon as possible after such contingency has been removed or such shipments may be canceled at seller's option. Date of 'Bill of Lading' is to be considered date of shipment." The buyers rejected the documents when tendered in London upon several grounds, namely, (1) That the sellers had not shipped the goods until Nov. 8 and 9, 1920. (2) That a proper Bill of Lading was not presented. (3) That a proper policy of insurance was not presented. The sellers assert that their non-shipment of the goods in September-October, 1920, is met by the strike clause. They also assert that the documents tendered to the buyers complied with the contract. It is admitted, and the Award states, that the points are to be decided by English Law. I shall not narrate the circumstances whereby (as is admitted) the goods were not shipped on board till Nov. 8 and 9, 1920. The facts found fall, I think, within the strike clause. The Arbitrators state that the delay was at all times beyond the sellers' control. The strike clause is very broadly worded. It is not confined to prevention. It refers to delay also. The words "or any contingencies whatever" seem to exclude the operation of the *ejusdem generis* rule. See, for example, *Larsen vs Sylvester*, 1908 Appeal Cases, at page 295, and *Travers vs Cooper*, 1915, 1 King's Bench at page 73.

That being so, the next question is whether the effect of the strike clause was merely to save the sellers from liability, or whether it operated also to debar the buyers from insisting that the goods had not been shipped in the months specified in the contract.

Upon the whole I think that the effect of the clause was to enable the seller (if facts within the strike clause prevented shipment September-October) to ship at a later date. I am not aware of any direct authority on the point. The case of *Brown vs Turner Brightman*, 1912 Appeal Cases at page 12 and the like decisions do not really touch the point. The decision in *Brooke Tool Co. vs Hydraulic Co.* (1920) 122 Law Times at page 126 turned upon different considerations. The clause must be read in a fair business sense. It effects two things, I think. It firstly saves the vendor from liability for delay, &c., caused by circumstances within the clause;

and secondly, it enables the seller, as a matter of right, to ship as soon as possible after the cause of delay has ceased to operate. It gives power to the seller to cancel. It gives no like power to the buyer.

In the case of *J. Aron & Co. vs Comptoir Wegmont*, I yesterday stated my views on the meaning and contractual effects of a condition for shipment at a specified time. I do not repeat them as a matter of right to ship at a later date than that expressed in the earlier part of the contract of sale. Here an express clause of the bargain enables the sellers as a matter of right to ship at a later date than that expressed in the earlier part of the contract of sale. I therefore find in favor of the sellers on the first objection of the buyers.

It thus becomes my duty to consider the serious and powerfully argued contention of the buyers, that the documents tendered did not conform to the contract. I will deal with those documents separately. I take first what I will call for convenience the bill of lading. That document was issued by the Swedish American Mexico Line, Ltd., of Gothenburg, Sweden. It is dated Nov. 8, 1920. It contains many clauses. The arguments before me turned on the earlier words of the bill of lading, and those only I set out. They are these: "Received in apparent good order and condition from D. A. Horan to be transported by the *S.S. Anglia*, now lying in the Port of Philadelphia and bound for Gothenburg, Sweden, with liberty to call at any port or ports in or out of the customary route or failing shipment by said steamer in and upon a following steamer, 280 bags Dense Soda." Perhaps I should add that the first of the many clauses in the bill of lading is this: "It is mutually agreed that this shipment is subject to all the terms and provisions of and all the exemptions from liability contained in the Act of Congress of the United States approved on the 13th day of February, 1893, and entitled 'An Act for the Navigation of Vessels.'" This Act of 1893 provides by Section 4: "That it shall be the duty of the owner or owners, master or masters, or agent of any vessel transporting merchandise or property from or between ports of the United States and foreign ports to issue to shippers of any lawful merchandise a bill of lading or shipping document stating, amongst other things, the marks necessary for identification, number of packages or quantity, stating whether it be the carrier's or shipper's weight, and apparent order or condition of such merchandise or property delivered to and received by the owner, master or agent of the vessel for transportation, and such document shall be *prima facie* evidence of the receipt of the merchandise therein described." I call attention to the words "Bill of Lading or shipping documents." The Act recognizes that there may be shipping documents fulfilling the requirements of the section and yet not bills of lading.

Now the buyers strongly contend that the document here tendered was not a bill of lading at all, and that in any event it was not such a bill of lading as was required by the contract. They call attention to the fact that the document does not acknowledge the goods to have been actually placed on board. It merely says that the goods have been received "to be transported by the *S.S. Anglia*." They further call attention to the words "or failing shipment by said steamer in and upon a following steamer." I

need scarcely say that I appreciate the vital nature of the buyer's contention, inasmuch as the form of document now before me is of frequent use at American ports. In order to test the matter it is necessary in the first place to consider the rights of a buyer under a c.i.f. contract. The strike clause here is a mere accident, and does not seem to affect the point at issue. For inasmuch as the duty of the vendors was to ship as soon as the contingency ceased to operate, and inasmuch as they were able to ship on Nov. 8 and 9, 1920, it follows that the time of shipment under the contract was that date.

What then are a seller's duties and buyer's rights under a c.i.f. contract? They were stated by Lord Blackburn in *Ireland & Livingstone* (1872) 5 Appeal Cases, page 395, at page 406, where he refers to a "bill of lading." So, too, in the well-known judgment of Mr. Justice Hamilton in *Biddell Bros. vs Horst Co.* (1911), 1 King's Bench, page 214, at page 221, where he says: "It follows that against tender of those documents, the bill of lading, invoice and policy of insurance which completes delivery in accordance with that agreement, the buyer must be ready and willing to pay the price." So per Lord Justice Kennedy, same volume, at page 956, "How is such a tender to be made of goods afloat under a c.i.f. contract?" "By tender of the bill of lading, accompanied in case the goods have been lost in transit by the policy of insurance. The bill of lading in law and fact represents the goods." See also Mr. Justice Scrutton in *Landauer vs Craven*, 1912, 2 King's Bench 94 at page 107. The latest statement is the opinion of Lord Birkenhead in *Johnson vs Taylor Bros. & Co., Ltd.*, 1920 Appeal Cases at page 149 where he says in speaking of the duties of a vendor under a c.i.f. contract, "He is bound in the second place to tender to the purchaser within a reasonable time after shipment the shipping documents, for example, the bill or bills of lading and a policy of insurance reasonably covering the value of the goods." I should mention also the notes to Scrutton & Mackinnon on Charterparties, article 59. If then a vendor under an ordinary c.i.f. contract is bound to tender a bill of lading, the question next arising is: What is meant by a bill of lading within such a contract?

The contract decides the rights of the buyer. The question is not as to the meaning of the phrase in a particular Act of Parliament or as to the possible meaning under other forms of contract. Nor is it material that a buyer objects to the document for ulterior motives. See for example Lord Cairns in *Bowes vs Shand* (1877) 2 Appeal Cases 455 at page 465, and per Lord Hatherley, same volume at page 476. A buyer, as those noble lords pointed out, is entitled to insist on the letter of his rights. As Lord Hatherley said: "You must bring the buyer within the four corners of the contract." A buyer moreover may have obvious business reasons for so insisting as he may have to implement his own bargain with rigorous subvendees. Now I consider that the phrase "bill of lading" as used with respect to a c.i.f. contract means a bill of lading in the sense established by a long line of legal decisions. Unless this meaning be given the matter is thrown into confusion.

In article 3 of Scrutton & Mackinnon on Charterparties and Bills of

Lading, is a definition which says: "A bill of lading is a receipt of goods shipped on board a ship signed by the person who contracts to carry them or his agent and stating the terms on which the goods were delivered to and received by the ship." This statement suggests at once an obvious and serious distinction between a receipt for goods actually shipped on board a particular ship and a receipt for goods which are at some future time to be shipped on board either a particular ship or an unnamed ship to follow her. This business distinction and varying results of the two seem to me to be plain. The legal distinction seems to me to be equally plain.

From the earliest times a bill of lading was a document which acknowledged actual shipment on board a particular ship. In Bennett's History of the Bill of Lading (Cambridge Press, 1914) at page 8 is this passage: "Desjardins says that towards the close of the 16th century the use of 'the Bill of Lading was widespread—he quotes a definition from Le Guidon 'de la mer, a document of that epoch, which defines the Bill of Lading as 'the acknowledgement which the master makes of the number and quality 'of the goods loaded on board.'" See Desjardins' Traite de Droit Commercial Maritime, Tome 4, Article 904. (Paris 1885.) It is clear, I may add, that the Bill of Lading sprang from the ship's book of lading which was a document of weight showing the goods actually put on board.

The famous case of *Lickbarrow vs Mason*, 2 Term Reports, at page 674, was discussed (1794). It decided that bills of lading were transferable by the custom of merchants. The finding of the jury as to the custom is set out at page 685 as follows: "By the custom of merchants bills of 'lading expressing goods or merchandise to have been shipped by any 'person or persons to be delivered to order or assigns have been and 'are at any time after such goods have been shipped and before the voyage 'performed for which they have been or are shipped negotiable or transferable by the shipper or shippers of such goods—" etc. The word negotiable in that special verdict really means no more than the word "transferable" or "assignable." See Scrutton on Charterparties' notes, article 56.

I am not aware of any decision which has modified the finding of the jury in *Lickbarrow vs Mason* as to the subject matter to which alone the custom of transferability applied. Apparently that custom and that custom only was operative when the Bills of Lading Act, 1855, was passed. (18 & 19 Vict., c. 111). Now that Act expressly recites the custom found in *Lickbarrow vs Mason* that then proceeds: "and whereas it frequently 'happens that the goods in respect of which bills of lading purport to be 'signed have not been laden on board." It thus seems plain that the Act was referring to documents acknowledging an actual shipment on board a specified ship. I need not refer to sections 1 and 2 of the Act. But section 3 says, "Every bill of lading in the hands of a consignee or endorsee for valuable consideration representing goods to have been shipped 'on board a vessel shall be conclusive evidence of such shipment as against 'the master or other persons signing the same . . ." etc. It seems clear that no assignee can invoke the benefits for example of section 3 unless the document actually asserts the goods have been shipped on board. The

whole point of the section seems to go if the document does not contain such an assertion. I will refer to this Act later.

Now in Blackburn on Sale, 3rd Edition (1909), page 421, is this statement: "A bill of lading is a writing signed on behalf of the owner of the ship in which goods are embarked acknowledging the receipt of the goods and undertaking to deliver them at the end of the voyage (subject to such conditions as may be mentioned in the bill of lading)." The common type of a bill of lading is given in Carver on Carriage by Sea, 6th Edition, part 54. It is worthy of observation that in the U. S. A. case of *Rowley vs Bigelow* (1832) 12 Pick 307, Chief Justice Shaw said: "The bill of lading acknowledges the goods to be on board and regularly the goods ought to be on board before the bill of lading is signed." See the note in Parson on Shipping (Boston) Vol. 1, page 187, where the learned author somewhat pointedly says: "It is a fraud on the part of the Master to sign the bills before the goods are on board." In Benjamin on Sale, 6th Edition, page 846, is this passage giving the result of the cases. "When delivery is to be made by a bill of lading the rule is that the seller makes a good delivery if he forward to the buyer, as soon as he reasonably can after the shipment, a bill of lading, whereunder the buyer can obtain delivery, duly indorsed effectual to pass the property or the goods, made out in terms consistent with the contract of sale, and purporting to represent goods in accordance with the contract, and which are in fact in accordance therewith." Apart from any authority to the contrary it seems to me that I must hold that the document here is not a bill of lading within the c.i.f. contract before me. It does not acknowledge the goods to be on board a specific ship, nor does it acknowledge a shipment on board at all. It leaves it uncertain as to whether the goods will come by the *Anglia* or some following ship. The word "following" is loose and ambiguous in itself. The document does not even say "immediately following," nor does it indicate that the "following ship" will belong to or be under the control of the person who issues the bill of lading. The document seems to me to be (in substance) a mere receipt for goods which at some future time and by some uncertain vessel are to be shipped. It is not even in the form of the New York Produce Exchange bill of lading set out in Carver, 6th Edition, app. A., page 971. The buyer is left in doubt as to actual shipment and actual ship. The sellers, however, submit that I am bound by the opinion of the Privy Council in "*The Marlborough Hill*," 1921, Appeal Cases, page 1. The buyers on the other hand contend that that opinion is erroneous and that I ought not to follow it. I need not scarcely state the deep diffidence and embarrassment I feel in discussing that weighty opinion. As Lord Phillimore himself, however, pointed out in *Dulien vs White*, 1901, 2 King's Bench 669, at page 683, a Privy Council advice is not binding on the King's Bench Division even as to the "*res decisa*." I wish to point out first that the actual decision in that case was merely that the bill of lading there in question (which closely resembles the one now before me) fell within section 6 of the Admiralty Court Act, 1865. It may be that the phrase "Bill of lading" in that section permits of a broad interpretation. I point out next that there is no

express statement in the "Marlborough Hill," that the document there in question actually fell within the Bills of Lading Act 1855. In the third place it seems to me to be clear that the Board did not consider the nature and effect of an ordinary c.i.f. contract or the decisions thereon in relation to the question before them. The case of *Bowes vs Shand*, 1877, 2, Appeal Cases, 455, was not even cited to the Board. Lord Phillimore, in reading the advice of the Privy Council, said (page 451): "There can be no difference in principle between the owner, master, or agent acknowledging that he has received goods on his wharf or allotted portion of quay or his storehouse awaiting shipment and his acknowledging that the goods have been actually put over the ship's rail." With the deepest respect I venture to think that there is a great difference between the two, both from a legal and business point of view. Those differences seem to me clear. I need not state them. If the view of the Privy Council is carried to its logical conclusion, a mere receipt for goods at a dock warehouse for shipment might well be called a bill of lading. At page 452 of the Report the Board say: "Then as regards the obligation to carry either by the named ship or by some other vessel, it is a contract which both parties may well find it convenient to enter into and accept. The liberty to transship is ancient and well established, and does not derogate from the nature of a bill of lading, and if the contract begin when the goods are received on the wharf, substitution does not differ in principle from transshipment." I do not pause to analyse these words. I only say that in my own humble view substitution and the right of transshipment are distinct things, and rest on different principles. The passage last cited can, I think, have no application at all to a c.i.f. contract which provides for a specific date of shipment. It will suffice if I say two things, First, that in my view the "Marlborough Hill" case does not apply to a c.i.f. contract such as that now before me. Secondly, that grounds for challenging the dicta of the Privy Council will be found in Article 22, and the notes and cases there cited, in Scrutton & Mackinnon, 10th Edition, as to what are called through bills of lading, in the lucid article in the *Law Quarterly Review* of October, 1889, Vol. 5, page 424, by Mr. Bateson, K. C.; and of July, 1890, Vol. 6, page 289, by the late Mr. Carver, and in Carver on Carriage, notes to Article 107. I do not doubt that the document before me is a "shipping document" within the U. S. A. Harter Act, 1893. I feel bound to hold, however, that it is not a bill of lading within the c.i.f. contract of sale made between the present parties.

I now consider the second document discussed before me. The buyers contend that the "Certificate of Insurance" tendered by the sellers was not a policy of insurance within the c.i.f. contract. It is headed "Certificate of Insurance." It is No. 767,922. It is issued by the Fireman's Fund Insurance Company of San Francisco, a well known office. The substantive words are these: "This is to certify that on the 8th of November, 1920, this Company insured under Policy No. 2,319 for D. A. Horan \$5,790 on 280 bags 58 per cent dense soda ash N. Y. & L. test valued at sum insured shipped on board of the *S. S. Anglia* and/or other steamer or steamers at and from Philadelphia to Gothenburg. And it is hereby

"understood and agreed that in case of loss, such loss is payable to the order of the assured on surrender of this certificate. This certificate represents and takes the place of the policy and conveys all the rights of the original policy holder (for the purpose of collecting any loss or claims) as fully as if the property was covered by a special policy direct to the holder of this certificate and free from any liability for unpaid premiums. Not valid unless countersigned by D. A. Horan. (Signed) F. H. and C. Robson, Managers. Countersigned D. A. Horan." Notice: "To conform with the Revenue Laws of Great Britain in order to collect a claim under this certificate it must be stamped within 10 days after its receipt in the United Kingdom." On the front of the certificate are certain conditions, of which the first is this: "This certificate is subject to the full terms of the policy in respect of being free from claim in respect of capture, seizure, detention, or the consequences of hostilities." At the back of the certificate are other conditions which I need not detail. Is this certificate a proper policy of insurance within the c.i.f. contract here made? I have read, I believe, all the cases on the rights and obligations of buyer and seller under c.i.f. contracts from *Ireland vs Livingstone* in 1872 Appeal Cases, page 395, and *Hickox vs Adam*, 1876 Appeal Cases, page 344, to *Johnson vs Taylor & Others*, 1920 Appeal Cases, page 144. Many decisions are cited in Benjamin on Sale, 6th Volume, page 850, and so on. In all the cases a "policy of insurance" is mentioned as an essential document. The law is settled and established. I may point out that in *Burshall vs Grimsdale*, 1906, 11 Commercial Cases, page 280, it was expressly provided by the contract that a certificate of insurance might be an alternative for an actual policy. I ventured in *Maubre Saccharine Co. vs Corn Products Company*, 1919, 1 King's Bench, page 198, to discuss the relevant authorities including the lucid judgment of Mr. Justice Atkin in *Groom Ltd. vs Barber*, 1915, 1 King's Bench, page 316—a judgment which I have again most carefully read. It seems plain that a mere written statement by the sellers that they hold the buyers covered by insurance in respect of a specified policy of insurance, is not itself a policy of insurance within a c.i.f. contract. See the Maubre case, 1919, 1 King's Bench, page 199. It seems plain also that a broker's cover note or an ordinary certificate of insurance are not adequate agreements within such a contract. See Mr. Justice Bailhache in *Wilson Holgate & Co.*, 1920, 2 King's Bench Division.

Does the present document fulfill the seller's contractual duty? In the Wilson Holgate case, paragraph 7, Justice Bailhache said: "It must be borne in mind that in dealing with certificates of insurance I am not referring to American certificates of insurance which stand on a different footing and are equivalent to policies, being accepted in this country as policies." It will be observed that Justice Bailhache used the word "accepted" and not the words "bound to accept." The sellers here rely on that passage and also on the notes to Scrutton on Charterparties, 10th Edition at page 185, where it is said: "A certificate of insurance issued by an insurance company under a floating policy upon which document the company can be sued would suffice in any case." The buyer strongly

challenges that view and his Counsel require me to express an independent opinion on the point. I do so with the greatest diffidence and reluctance in view of the weight carried by even the dicta of such experienced and distinguished Judges as Justice Scrutton and Justice Bailhache. I feel bound to express my view not upon a question of business convenience but upon the strict law of the matter. I assume that this document (which is not stamped) was given under a floating policy issued by the Insurance Company to D. A. Horan. Now the certificate is not a policy. It does not purport to be a policy. This is conceded by Mr. Hastings in his able argument for the sellers. It is a certificate that a policy was issued to D. A. Horan, and it incorporates the terms of that policy. Those terms I do not know, nor is there anything before me to indicate that the buyers knew them. The certificate does not show whether that policy was in a recognized or usual form or not. The certificate does therefore contain all the terms of the insurance. Those terms have to be sought for in two documents, namely, the original policy and the certificate. But even if this document is not a policy yet the sellers say it is "equivalent to a policy." In connection with that phrase it is well to quote from another part of the Judgment of Justice Bailhache in the *Wilson Holgate Case*, 1920 2 King's Bench at page 9. He there says: "He, the buyer, cannot be compelled to take a document which is something like that which he has agreed to take. He is entitled to have a document of the very kind "which he has agreed to take or at least one which does not differ from "it in any material respect." This leads me to ask whether the document before me differs in any material respect from a policy of insurance. To begin with, I do not see how the buyer here could know whether the document he got was of a proper character (one he was bound to accept) unless he saw the original policy, and examined its conditions, whether usual or otherwise. In the next place I feel that a certificate of insurance falls within a legal classification, if any, different to that of a policy of insurance. The latter is a well known document with clearly defined features. It comes within definite, established and statutory legal rights. A certificate, however, is an ambiguous thing; it is unclassified and undefined by law; it is not even mentioned in *Arnould*. No rules have been laid down upon it. Would the buyer sue upon the certificate or upon the original policy plus the certificate? If he sued simply on the certificate he could put in a part only of the contract, for the other terms of the contract, namely, the conditions of the actual policy, would be contained in a document not in his control and to the possession of which he is not entitled. Thirdly, I point out that before the buyer could sue at all he would have to show that he was the assignee of the certificate. See *Arnould*, section 175-177. In what way can he become the assignee? It is vital to remember the provisions of the *Marine Insurance Act*, 1906. Now the relevant statutory provision is Section 50 (3), which says: "A marine policy may be assigned by endorsement thereon or in any other customary manner." This sub-section, however, only applies, so far as I can see, to that which is an actual marine policy. Section 90, the interpretation clause says: "In "this Act unless the context or subject matter otherwise requires 'policy'

"means a marine 'policy.'" The Act contains no reference, express, or implied, to a certificate of insurance. Section 22 says: "Subject to the provisions of any Statute a contract of marine insurance is inadmissible in evidence unless it is embodied in a marine policy in accordance with this Act." If, as is admitted, this document be a certificate only and not a policy it therefore seems not even to be admissible in evidence before me. If the certificate does not fall within the Marine Insurance Act it appears to be only assignable by writing in accordance with the provisions of the Judicature Act, 1873, Section 25 (6). The certificate may have less legal effect than a slip, as to which see Arnould, paragraph 34, and Section 21 of the Marine Insurance Act.

I mention these considerations briefly. Time does not permit to discuss them further or to develop their significance or to emphasize the points arising under Sections 91 to 95 of the Stamps Act, 1891. In my view the Act of 1906 deals with marine policies only. It does not, I think, cover other documents, although they may be said to be the business equivalent of policies. I do not think that the Act of 1906 covers the document now before me. In my humble view a document of insurance is not a good tender in England under an ordinary c.i.f. contract unless it be an actual policy and unless it falls within the provisions of the Marine Insurance Act, 1906, as to assignment and otherwise. I must therefore hold that the buyers were entitled to reject the documents upon the ground that no proper bill of lading and no proper policy of insurance were tendered by the sellers in conformity with the c.i.f. contract. I abstain from amplifying this Judgment by the citation of other authority or the mention of further reasons in support of the conclusions I have deemed it my duty to state. It may well be that this decision is disturbing to business men. It is my duty, however, to state my view of the law without regard to mere questions of convenience. I desire to add four remarks: (1) That there is no finding or evidence before me of any course of dealing between the parties; (2) That there is no finding or evidence before me of any custom or general usage which modifies the long and clearly established legal rights of a buyer under a c.i.f. contract. If any such custom or usage be asserted then the point can be dealt with in some future action in the Commercial Court. Whether such an assertion can be proved may well be a question of doubt in view of the matters appearing in the *Manlie* case, 1919, 1 King's Bench at page 206. See, too, the *Wilson Holgate* case, 1920, 2 King's Bench at page 8, where Justice Bailhache said: "I am not satisfied that since *Ireland vs Livingstone* was decided any custom has arisen which obviates the necessity for a tender by the seller of a policy of insurance if the buyer requires it." (3) It may well be that legislation is needed to enlarge the operation of the Bills of Lading Act, 1855, and the Marine Insurance Act, 1906. (4) That the difficulties indicated in this Judgment can be easily, promptly and effectively met by the insertion of appropriate clauses in c.i.f. contracts.

For the reasons given I find in favor of the buyers with the results stated in the Award. The sellers must pay the costs of the proceedings before me.

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